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Cross-border venture capital performance: Evidence from China

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ABSTRACT

This paper investigates the determinants of cross-border venture capital (VC) performance in the Chinese VC market. We focus on the impact of foreign VC firms' (VCs') human capital and domestic entrepreneurs' experience on the performance of both VC investments and portfolio companies using logit and Cox hazard models. After controlling for portfolio company quality, domestic VC industry development, domestic exit conditions and a number of other factors, little correlation was evident between VC performance and foreign VCs' human capital, such as experience, networks and reputation. In contrast, the domestic entrepreneurs' experience is crucial to VC performance. In particular, if an entrepreneur has more general experience in terms of the number of companies previously worked for or more special experience in terms of the number of companies previously served as a CEO or top manager, a portfolio company is more likely to pull off a successful exit through IPO or M&A, and the VCs are also likely to shorten their investment duration in the portfolio company.

1. Introduction

Since the founding of the American Research and Development Corporation in the U.S. in 1946, venture capital (VC) has experienced considerable growth. Many of today's multinational companies, such as Apple, Intel, Google and Microsoft, were funded by VC firms (VCs) in their early development stages. VCs are characterized as being “active investors” in financing startups in high-tech industries (Sahlman, 1990; Barry et al., 1990; Lerner, 1994; Kaplan and Strömberg, 2003). Besides providing funds, they add value by engaging in monitoring, recruiting executives and directors, formulating strategies, modernizing firms,

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Table 1
VC industries in China and the U.S. during 2002–2008. This table lists fundraising, the number of new funds, investment amount and the number of deals in the VC industries of China and the U.S. The data sources are Zero2IPO at http://www.zero2ipo.com.cn and the National VC Association at http://www.nVCa.org.

Year	Fundraising (US$M)		Number of new funds		Investment amount (US$M)		Number of deals	
	China	U.S.	China	U.S.	China	U.S.	China	U.S.
2002	1298.0	3774.0	34	175	418.0	21,250.0	226	3105
2003	639.0	10,640.9	28	151	992.0	19,278.2	177	2952
2004	699.0	19,159.0	21	211	1269.0	22,117.5	253	3104
2005	4067.0	28,767.4	29	239	1173.0	22,922.2	228	3167
2006	3973.1	31,925.0	39	241	1777.42	26,334.4	324	3705
2007	5485.0	36,064.9	58	251	3247.05	30,639.3	440	3984
2008	7310.1	28,395.9	116	221	4210.47	28,076.9	607	3929

helping with fundraising activities and in other ways (Barry et al., 1990; Bottazzi et al., 2008). Such active involvement has been shown in theory to reduce information asymmetry and agency problems (Admati and Pfleiderer, 1994; Bergemann and Hege, 1998; Neher, 1999; Cornelli and Yosha, 2003; Casamatta, 2003; Schmidt, 2003; Wang and Zhou, 2004) and has been shown empirically to create public companies (Barry et al., 1990), enhance innovations (Kortum and Lerner, 2000), and improve performance (Bottazzi et al., 2008; Hochberg et al., 2007; Gompers et al., 2008).

VC funding in emerging markets is provided by either domestic or foreign VCs, but especially foreign ones. Cross-border VC investment means investments by foreign VCs in companies in other nations. Today's globalization of venture capital has been marked by an increasing number of cross-border entries of VCs from developed markets into emerging markets (Patricof, 1989; Sagari and Guidotti, 1992; Aylward, 1998). The entry of foreign VCs helps firms in emerging markets by shortening and reducing the costs of the learning process (Black and Gilson, 1998). Cross-border VC is essential in growth-oriented and high-risk new ventures in emerging markets where the domestic supply of VC is limited (Dossani and Kenney, 2002). Recognizing its importance, a number of developing countries have taken steps to stimulate and foster cross-border VC investments.

There have been an increasing number of studies of cross-border VC, but there is still much to learn about its investment strategies, monitoring mechanisms, exit methods, and short and long-run performance. To help fill this gap, this study is designed to investigate cross-border VC performance using Chinese data. The motivation for choosing China lies in the fact that China's VC market has experienced rapid expansion in recent years, and that it has the potential to expand much further. Also, foreign VCs dominate China's VC industry. China is now the largest net importer of VC funds, followed by Sweden, Canada, the UK, India, and France (Aizenman and Kendall, 2008).

China's own VC industry started in the mid 1980s. It experienced slow development in its first 10 years, but after the mid 1990s it grew rapidly and total investments have now reached No. 1 in Asia and No. 5 in the world (by some statistical rankings). An increasing number of well-known foreign VCs have now entered China, including Crystal Ventures, DCM-Doll Capital Management, Intel Capital, and JPMorgan Partners. Table 1, based on the China VC Report by Zero2IPO[1] and information from the U.S. National Venture Capital Association, compares the VC industries of China and the U.S. during 2002–2008, covering fundraising, the number of new funds, total investment amount and the number of deals. Table 1 indicates that China's VC industry has experienced explosive growth in the past several years, but its total size is still much smaller than that of its U.S. counterpart.

Even though foreign VCs constitute only about one quarter of China's VC industry in number, they dominate China's VC industry in many respects. Zeng (2004) has shown that most VC investments in China involve foreign VCs. According to the China VC Report by Zero2IPO, foreign VCs significantly outperform

[1] Zero2IPO is a well-known integrated service provider in the Chinese venture capital/private equity (VC/PE) industry. It has been conducting large-scale surveys and compiling a series of reports/directories on the VC industry since early 1999. The Zero2IPO database is China's first VC/PE investment industry database, which is also the only source for comprehensive and up-to-date information on VC/PE funds, firms, executives, and portfolio companies in China.