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Cross-border venture capital investments in Asia: Selection and exit performance ☆

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ABSTRACT

We investigate the investment behavior and exit performance of VCs that have pursued expansion outside their home locations, specifically, in Asia. Our findings indicate that, in the Asian VC markets, foreign VCs have relative advantages over local VCs in terms of size and experience while they are at a disadvantage in information collection and monitoring due to both geographic and cultural distances. When investing alone, foreign VCs are more likely to invest in more information-transparent ventures. Partnership with local VCs helps alleviate information asymmetry and monitoring problem and has positive implication for the exit performance of local entrepreneurial firms. Specifically, we find that after controlling for the endogeneity of selection, firms with both foreign and local VC partnership are about 5% more likely to successfully exit.

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1. Executive summary

The internationalization of venture capital (VC) investments has become a trend recently. The emerging markets such as China and India, where the VC industries are very much underdeveloped, have attracted a lot of attention and interest from international VCs. Among the various risks and challenges in the cross-border venture capital investments, the information asymmetry and moral hazard that arise due to geographical and cultural distances seems to be a universal concern. There is a dearth of empirical work on how frictions associated with geographic distance and different cultural environment impact VCs' investment behavior and how VCs respond to these issues, as well as how effective these solutions are, with a few exceptions which focus on developed economies such as U.S. and European area (Guler and Guillen, 2010; Manigart, 1994; Manigart et al., 2002; Meuleman et al., 2009;

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Sapienza et al., 1996). Our paper fills this gap by empirically examining investments by foreign VCs and their performances in Asian countries during the 1996–2006 period. We empirically examine a number of hypotheses that relate to the formation of different venture ownership types and their impact on the exit performance of the entrepreneurial firms. Specifically, we consider the following factors, the information friction and monitoring cost associated with both the geographic and cultural distances of the VCs to the companies funded, and the partnership between foreign and local VCs.

Our empirical results show that in the Asian VC market, foreign VCs play an important role. More than 70% of the $35 billion funding in the Asian VC market from 1996 to 2006 is provided by foreign VCs. Foreign VCs invest in more information-transparent ventures when they invest alone. By forming partnership with local VCs, foreign VCs invest more aggressively in early stage ventures and ventures in technology industries than those acting alone. We further show that the cultural distances between the origin country of the foreign VC and the country of the local VCs not only discourages the formation of partnership between the two, but also has a negative impact on the exit performance of ventures.

We find that partnership between foreign and local VCs helps alleviate the frictions associated with geographical and cultural distances. Specifically, entrepreneurial firms jointly invested by foreign and local VCs are about 5.0% more likely to successfully exit than those invested by foreign VCs alone and by local VCs alone. This finding is robust after we control for the endogeneity of selection that more experienced VCs attract the better entrepreneurial deal and thus have a better chance of success using the propensity score matching methodology. In general, the findings in this paper shed additional light on the investment selection behavior and exit performance of VCs when they invest across borders. In particular, the paper studies how VCs deal with information asymmetry and moral hazard due to both geographical and cultural distances when investing in Asia, which is far less explored in the existing international venture capital literature. While it is well documented in the theoretical literature that cultural distance plays an important role in international diversification, the empirical findings are largely mixed. Our evidences suggest it has a negative impact on both the formation of partnership between foreign and local VCs and the exit performance of ventures. Our study extends the syndication literature by showing that partnership produces synergy in cross-border venture capital investments by reducing frictions associated with both geographical and cultural distance. The study also has implications for practitioners interested in investing in the Asian VC market.

2. Introduction

Cross-border venture capital (VC) investments are increasing manifold in terms of number of deals and capital involved. Surveys on the global trends in venture capital investments show that more than half of U.S. VCs plan to expand internationally, particularly in China and India (Deloitte, 2006, 2007). This trend raises several practical challenges for both investors and entrepreneurs. Among the various risks and challenges, a lack of knowledge or expertise in the local business environment due to geographical and cultural distances seems to be a universal concern. The trend also raises several questions that are not thoroughly studied in the existing academic literature. For instance, how do frictions associated with geographic distance and different cultural environments impact VCs' investment behavior? Does syndication between foreign and local VCs help reduce these frictions? How successful are these cross-border investments in terms of exit performance?

There is a dearth of empirical work on these questions, with a few exceptions which focus on developed economies such as U.S. and European area (Guler, and Guillen, 2010; Manigart, 1994; Manigart et al., 2002; Meuleman et al., 2009; Sapienza et al., 1996). Our paper addresses the above questions by empirically examining investments by foreign VCs in Asian countries during the 1996–2006 period. We focus our analysis on the Asian market for the following reasons. First, this market is young and relatively underdeveloped and thus relatively less studied in the literature with a few exceptions (Bruton and Ahlstrom, 2003; Bruton et al., 2005; Bruton and Lau, 2008; Wright and Lockett, 2003; Young et al., 2008). Second, given the undeveloped nature of the local venture capital industry and the uniqueness of cultural and social norms in Asia, it provides an excellent setting to examine how foreign (non-Asian) VCs respond to the substantial frictions associated with both geographic distances and cultural disparity, and the effectiveness of their responses. Third, given the fast growth and increasingly important economic power of China and India, this area has attracted and continues to attract many foreign investors including foreign venture capital investors. Our study thus provides timely insights for the practitioners planning such expansion in this area.

We examine a number of hypotheses that relate to the formation of different venture ownership types and their impact on the exit performance of the entrepreneurial firms. Specifically, we consider the following factors, the information friction and monitoring cost associated with both the geographic and cultural distances of the VCs to the companies funded, and the partnership between foreign and local VCs.

We start by examining the differences between foreign and local VCs in the Asian markets. Our empirical results indicate that in the Asian VC market, foreign VCs play an important role. Among the total of $35 billion investment in the Asian VC market reported by VentureXpert, from 1996 to 2006, more than 70% of the funding is provided by foreign VCs.[3] There are partnerships between foreign and local VCs either through syndication in the same round of financing or funding the same venture in different rounds. However, foreign VCs, more often, act alone (without local VCs) in making investments in the Asian VC market.

Second, we examine how the frictions associated with geographic distance and cultural disparity impact VCs' behavior when they explore their investment opportunities in unfamiliar territory. We find that foreign VCs are less likely to invest in seed or early stage firms or participate in the very first round, which is consistent with these VCs avoiding more informationally opaque

[3] The data reported by VentureXpert may not represent the true population.

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