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Do local and international venture capitalists play well together? The complementarity of local and international venture capitalists☆

Thomas J. Chemmanur [a,*], Tyler J. Hull [b], Karthik Krishnan [c]

[a] Fulton Hall 336, Carroll School of Management, Boston College, Chestnut Hill, MA 02467, United States
[b] College of Management, University of Massachusetts Boston, MA 02125, United States
[c] 414C Hayden Hall, D'Amore-McKim of Business, Northeastern University, Boston, MA 02115, United States

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ABSTRACT

We find that entrepreneurial firms in emerging nations backed by syndicates composed of international and local venture capitalists have more successful exits and higher post-IPO operating performance than those backed by syndicates of purely international or purely local venture capitalists. We control for the potential endogenous participation and syndication by international VCs using instrumental variables analyses and a natural experiment and find a causal effect of international VC participation on successful outcomes. International VCs face disadvantages in their investments due to the lack of proximity to the entrepreneurial firm. Using air service agreements between countries as an exogenous change in effective proximity, we find that entrepreneurial firms backed by international VCs are more successful when travel becomes easier between the two countries. Overall, our results indicate that the greater venture capital expertise of international venture capitalists and the superior local knowledge and lower monitoring costs of local venture capitalists are both important in obtaining successful investment outcomes.

Executive summary

In recent years, venture capital (VC) investments across national borders have seen a significant increasing trend. Such cross-border investment in venture capital markets has increased from 10% of all venture capital investments in 1991 to 22% in 2008 (based on number of venture capital investments). An important driver of this increase is the significant upward trend in international venture capital investments in emerging nations over this time period. At the same time, there has a significant development of local VC industries in many emerging as well as developed countries around the world. In this paper, we study

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* Corresponding author.
E-mail addresses: chemmanu@bc.edu (T.J. Chemmanur), tylerjhull@gmail.com (T.J. Hull), k.krishnan@northeastern.edu (K. Krishnan).

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international investments by VCs and analyze the benefits of international VCs forming syndicates with local VCs to invest in entrepreneurial firms in various countries around the world.

Compared to local VCs, VCs choosing to invest in foreign markets ("international VCs") may face significantly higher costs of screening potential investee firms and monitoring these firms after investment due to their lack of proximity to these firms. Such VCs may also face significant differences in context, culture, and institutional environment between their home country and the country of the entrepreneurial firm (Li et al., 2014; Guler and Guillen, 2010). Syndication with local VCs may be a mechanism through which international VCs may be able to overcome such disadvantages. On the positive side, international VCs are likely to have considerably greater expertise relative to local VCs in helping entrepreneurial firms to become successful. We therefore examine whether investments by syndicates of international and local VCs are indeed more successful in helping entrepreneurial firms succeed (rather than syndicates of each type of VC alone), and attempt to understand how cross-border syndication by international VCs with local VCs allow them to take advantage of their complementarities with local VCs.

Using a sample of cross-border VC investments, we find evidence that firms backed by syndicates consisting of both international and local VCs are indeed the most likely to exit successfully and have better post-IPO operating performance. Further, using instrumental variable analyses and a natural experiment, we show that including international VCs in the investing syndicate indeed has a positive and causal effect on exit.

We next analyze a channel through which geographic proximity may affect cross-national syndication and venture success. We conjecture that the international VCs' proximity disadvantage may arise from scarce human assets (the general partners of VCs), as opposed to physical assets such as offices (Giroud, 2013; Bernstein et al., 2016). In particular, lack of proximity may make it harder for international VC general partners to monitor the progress of their portfolio firm by attending board meetings, giving advice, and supporting the ongoing business operations of the firm: in other words, lack of proximity may create obstacles to effective monitoring of portfolio firms by international VCs.

Our findings are consistent with the above conjecture. We find that portfolio firms in a foreign country in which international VCs have already invested have a higher likelihood of successful exit, once there is a subsequent (and exogenous) increase in the availability of easier air travel options between the VCs' country and the portfolio firm's country (due to the establishment of an air services agreement (ASA) between these two countries). Moreover, this effect is primarily driven by international VCs who do not syndicate with a local VC. In other words, we are able to show that firms backed by a syndicate consisting only of international VCs (whose general partners face a significant proximity disadvantage with respect to their portfolio firms), perform better after the ease of travel between the international VCs' home country and a portfolio firm's country has increased, thus effectively overcoming the international VCs' proximity disadvantage.

1. Introduction

In recent years, venture capital (VC) investments across national borders have started to trend upwards (Wright et al., 2005; Aizenman and Kendall, 2012). Foreign or cross-border investment in venture capital markets has increased from 10% of all venture capital investments in 1991 to 22.7% in 2008 (based on number of venture capital investments). An important driver of this increase is the significant upward trend in international venture capital investments in emerging nations over this time period.[1]

Prior literature in this area has analyzed how cultural, legal, and institutional distances between the country of the VC and that of the entrepreneurial firm can impact investment strategies, investment success, and syndication strategies (Li et al., 2014; Dai et al., 2012; Guler and Guillen, 2010; Hazarika et al., 2013). With certain exceptions (including Dai et al., 2012 and Cumming et al., 2014), there has been little research on the effectiveness of international versus local venture capitalists in adding value to entrepreneurial firms and on the determinants of collaboration between the two types of venture capitalists. We add to these studies by providing causal evidence on the contribution of international investors to VC-backed firm success, and by suggesting a mechanism through which physical proximity may impact VC syndication, namely through the effective time required to travel.[2] We also provide evidence on the impact of local and international VC syndication on the post-IPO performance of exited VC-backed firms.

International venture capitalists have considerable expertise in helping entrepreneurial firms to become successful through better deal structure, providing product market support, professionalizing firm management, setting effective incentive schemes, and through monitoring firm management (Hellmann and Puri, 2000, 2002; Chemmanur et al., 2011). This expertise effect is likely to be stronger for investments in emerging nations, where local VCs are likely to have less experience in such investments. In contrast, local venture capitalists may enjoy a significant advantage in their home markets in terms of their information about local market conditions and investment opportunities (Makela and Maula, 2008). Further, local venture capitalists may be able to monitor their investments more easily because of proximity.[3] International venture capitalists can overcome their disadvantages in these respects by syndicating with local VCs and taking advantage of their complementary skills (consistent with Lerner, 1994; Brander et al., 2002).[4]

[1] For instance, in 2011, Accel closed two funds totaling $1.3 Billion for investing in China and Bessemer Venture Partners closed a $1.6 Billion fund which will invest in early stage companies across the world.

[2] Note that, by international VCs, we refer to cross-border VC investors from both the U.S. and other countries, both of which are present in our sample.

[3] Note that we use VC fund location to define whether or not the investing venture capitalist is local or international through the paper.

[4] The difficulties in monitoring international investments by venture capitalists have been commented upon in the popular press. See, e.g., "Redpoint and BV Capital form Brazilian V.C. Firm," New York Times Dealbook, March 5, 2012. To quote, "For the last couple of years, Redpoint partners have frequently travelled to Brazil, often visiting for a full week each trip, saying the lack of direct flights from San Francisco to Brazil makes a weeklong stay the only efficient way to conduct business there." The news article goes on to quote U.S. venture capitalists as seeking to ease difficulties such as the need for excessive travel by teaming up with local venture capitalists.