Governmental versus Private Venture Capital: Implications for Young Firm Internationalization

Katja Bringmann  
University of Antwerp  
Transport and Regional Economics  
katja.bringmann@uantwerpen.be

Abstract
Governmental versus private venture capital: Implications for young firm internationalization The aim of this study is to explore the role of venture capital (VC) investors for venture internationalization, whereby a distinction is made between two types of VC, independent and governmental sources. VC investors do not only provide their portfolio companies with financial resources, but also transfer relevant business knowledge and skills. Using a qualitative-narrative approach, we study how entrepreneurs utilize their venture capitalists’ knowledge resources to bring forward new venture internationalization. Hereby we distinguish between four types of knowledge components: know-what, know-why, know-how and know-who. The study contributes to the international entrepreneurship literature by demonstrating how different types of VC investors influence the internationalization attempts of their portfolio companies. It also sheds light into the underlying mechanisms of knowledge sharing between VC investors and entrepreneurs, distinguishing between organizational structures of VC funds.

Jelcodes:G24,F23
Governmental versus Private Venture Capital: Implications for Young Firm Internationalization

Katja Bringmann
Department of Transport and Regional Economics, University of Antwerp

- Preliminary version -

Work in progress – please do not cite or distribute without permission

Abstract
The aim of this study is to explore the role of venture capital [VC] investors for venture internationalization, whereby a distinction is made between two forms of VC funds, independent and governmental. VC investors do not only provide their portfolio companies with financial resources, but also transfer relevant business knowledge and skills. Using a qualitative-narrative approach, we study how entrepreneurs perceive the value addition by different types of VC investors concerning new venture internationalization. Hereby we distinguish between four types of knowledge components that facilitate foreign market entry: know-what, know-why, know-how and know-who. Based on in-depth case studies, we built a conceptual framework illustrating differences in the perceived value-addition of VC investors for venture internationalization.

Keywords: Internationalization, venture capital, new venture internationalization, knowledge sharing, fund characteristics

1. Introduction
In countries with only limited market size, internationalization has become a crucial element of young high potential firms’ growth strategy (Mäkelä & Maula, 2005). To successfully internationalize, knowledge has been identified to play a key role (Eriksson, Johanson, Majkgård, & Sharma, 1997; Fernhaber, Mcdougall - Covi, & Shepherd, 2009; Johanson & Wiedersheim - Paul, 1975; McDougall, Shane, & Oviatt, 1994; Oviatt & McDougall, 1997). Instead of incrementally building up their knowledge stock, ‘born globals’ or ‘international new ventures’ often make use of external knowledge resources to attain a competitive advantage. Venture capitalists [VCs] constitute such an external knowledge source. The diversity of venture capital providers and the continuing globalization of markets is calling for a better understanding of the specific resources provided by each type of investor to support their portfolio company’s internationalization attempts. Differentiating along types of investors, this study examines how entrepreneurs perceive the knowledge sharing capacities of their venture capitalists with respect to foreign market entry.

Existing research shows that entrepreneurs do not only search for venture capital to obtain crucial monetary assets, but also because VCs transfer relevant business knowledge and skills. Private venture capitalists are often themselves
ex-entrepreneurs or have gathered extensive business experience in the private sector beforehand. The knowledge, skills and industry contacts they developed during their prior careers are regarded as useful resources facilitating the strategy and growth development of the venture in its home market (Baum & Silverman, 2004; Gorman & Sahlman, 1989).

Whereas the overall value adding role of VCs has been widely acknowledged in the literature, the majority of these studies focuses solely on one type of VC: professionally managed independent funds. Not much is known whether there exist differences in value addition along different types of VC investors. Differences in monitoring and mentoring style are however expected especially between independent and governmental VC providers. Shareholders define a fund’s objectives and goals and evaluate its profit margin (Knockaert et al., 2006). Whereas for independent VCs profit maximization is the leading investment rational, public VC funds are primarily intended to further regional economic growth.

Based on their varying organizational structure, governance mechanisms and goals, VC investors are more heterogeneous in their characteristics than commonly assumed in the literature, which suggests differentiating between them (Bertoni, Colombo, & Grilli, 2013; Colombo & Grilli, 2010; Croce, D’Adda, & Ughetto, 2015). This article therefore aims at analyzing the internationalization path of businesses by distinguishing between firms that receive VC from governmental funds and those that are backed by independent VC firms or mixed syndicates. We focus on two interrelated questions: (1) ‘How do entrepreneurs perceive the knowledge sharing role of venture capitalists concerning internationalization?’ and (2) ‘Do entrepreneurs experience differences in knowledge sharing behaviors that are symptomatic for the type of VC fund?’.

To our knowledge, this is the first attempt to disentangle types of VC investors and bring into focus the effectiveness of governmental VCs in shaping venture internationalization. We thereby respond to the call of past studies emphasizing the importance of more in depth research on different types of VC and their value addition (Luukkonen, Deschryver, & Bertoni, 2013). Particularly concerning the performance of governmental venture capitalists [GVCs], prior studies have emphasized the need for more in-depth research (Bertoni & Tykvová, 2015; Leleux & Surlemont, 2003; Lerner, 2009).

To investigate if VCs are valuable for new venture internationalization and to learn more about the mechanisms how they bring forward or hamper foreign market entry of their portfolio companies, we apply a qualitative approach. Semi-structured interviews with Belgian high tech entrepreneurs are conducted. Contrary to prior definitions of internationalization as merely the presence of exports, the phenomenon is defined more broadly in this study as “discovery, enactment, evaluation, and exploitation of opportunities – across national borders – to create future goods and services” (Oviatt & McDougall, 2005, p. 540).
The findings do not only contribute to the international entrepreneurship literature and cross-border venture capital research, but they are also of relevance to national and regional policy makers. Economic openness and firm internationalization are important vehicles for the growth, innovativeness and prosperity of countries and regions. A detailed analysis of the effectiveness of GVCs in promoting venture internationalization will help academics and institutional actors alike to identify barriers and drivers of new venture internationalization and improve programs enabling high growth firms to broaden their geographic scope.

The paper is structured as follows: First, we review relevant prior findings on venture internationalization. Then, a typology of knowledge components with respect to firm internationalization is provided. The methodology and a description of the data are discussed in section 4. Section 5 discusses the findings retrieved from the interviews. Finally, some concluding remarks, limitations and avenues for further research are provided.

2. Young Firm Internationalization

The entry of foreign markets is associated with higher transaction costs and competitive disadvantages compared to indigenous firms. Firms maintaining operations in different markets have to cope with language barriers and other cultural and legal disparities. Despite these barriers, Bloodgood, Sapienza, and Almeida (1996) mention two key reasons from the perspective of the entrepreneur to pursue internationalization: First, ventures seek international markets to stay competitive. For some firms the domestic market is not sufficient in size to realize economies of scale. Second, the firm possesses unique resources, like international experience of the management team, that suggest and facilitate entering a non-domestic market. Venture capital backed organizations have high growth ambitions making an internationalization strategy compulsory, especially in countries with relatively small market size.

In early models of internationalization, a lack of resources and ‘liability of newness’ constraints have been regarded as impediment to foreign market entry by young firms. "Liability of newness” describes the lack of internal resources by new firms, such as strategic assets, legitimacy, stable organizational structures and financial resources, which newly establish companies often face. Given young firms resource constraints, the focus of the internationalization literature has for long concentrated on large organizations. In the initial ‘Uppsala model’ (Johanson & Vahlne, 1977) internationalization is regarded as an incremental organizational learning process that takes place within the firm. Firms first obtain knowledge in their domestic markets before gradually expanding their activities to foreign markets (Johanson & Wiedersheim - Paul, 1975).

In contrast to traditional internationalization models and despite limited internal resources, some young firms internationalize right from their inception.
The observation that not only long established organizations stepwise find their way abroad, but that also companies at a young age geographically diversify their business activities, has coined the term ‘international new ventures’ (Oviatt & McDougall, 1994). The international new venture literature stresses that young firms, instead of internally creating the necessary resources, can fall back on external knowledge sources. Utilizing external knowledge resources, they become able to internationalize at an early stage. VCs have been suggested to constitute such an external knowledge source (Mäkelä & Maula, 2005).

VC investors get actively involved in their portfolio companies after deal closure and it is widely accepted that they do not only equip their ventures with financial assets, but also with a wide range of non-financial resources. For example, they provide valuable knowledge and strategic advice to their ventures (Lerner, 1995; Sapienza, Manigart, & Vermeir, 1996). They make available crucial network contacts, assist with strategy formulation and decision-making (Maula, Autio, & Murray, 2005), search for additional rounds of financing, and reveal business opportunities. In addition, VCs help their ventures to overcome “liability of newness” related problems. Being associated with a particular VC, young firms can “lend” the reputation of their creditors to signal reliability and credibility on their behalf to third parties. This can solve problems related to the lack of legitimacy resulting from new firms’ limited track record.

2.1. Types of Venture Capital Funds
Prior research shows that the investment patterns, but also the degree of post-investment non-monetary support provided to young firms varies across investors (Sapienza et al., 1996). The degree of involvement in their target companies ranges from full immersion with business activities through frequent face-to-face encounters to a hands-off approach. Whereas this can be a result of the circumstances and characteristics of an investment, also the form of VC funds and their associated investment goals are likely to affect investors’ value-adding resources.

Different types of VC funds exist that can be distinguished on basis of their ownership and governance structure. In this paper, we focus on two forms of VC, independent and public ownership.

Independent funds constitute the most common type of VC. They are managed by a VC firm, the ‘general partner’ and obtain their capital from a number of private investors, the ‘limited partners’, such as institutional investors (insurance companies, pension funds) as well as foundations and wealthy individuals. It is the VC firm that decides and controls where the fund’s money is consequently invested in. The limited partners only receive a return on their investment when the startups financed by their fund successfully exits. This happens mostly at the end of the lifespan of funds. In Europe, funds are generally set up for 3-7 years. During this period, the venture capitalist is expected to work with the portfolio company to develop its business activities and make it successful. Optimally a fund achieves a return on investment of 30%. Besides obtaining a profit share or carried interest, for VC managers the capitalization of new funds gets facilitated if they possess a good track record of successful past
investments. Consequently, managers of independent VC funds primarily seek to maximize the return on their investment and bring their target companies to a fast public exit.

A second category of VC funds comprises public VC funds. Public sources of VC or ‘governmental VC funds’ are defined by Grilli and Murtinu (2014, p. 1524) as “funds that are managed by a company that is entirely possessed by governmental bodies”. Their goal is to stimulate the local startup ecosystem and close funding gaps with respect to early stage companies. In contrast to private funds, public VC funds are less focused on high monetary returns, but rather on technological outcomes that benefit society and the economy as a whole (Knockaert, Lockett, Clarysse, & Wright, 2006).

Grilli and Murtinu (2014) reveal large deficiencies in the value-addition of public VC funds. GVCs, compared to private funds, lack in adequately supporting business decisions of their target firms with their experience and knowledge (Knockaert, Lockett, Clarysse, & Wright, 2006; Luukkonen, Deschryvere, & Bertoni, 2013). Ventures that received VC from public funds are found to show a lower post-initial public offering [IPO] market performance than comparable ventures that obtained other types of VC funding, and especially independent VC (Tyková & Walz, 2007). Only if they syndicate with independent VC firms and if they are not inheriting a lead position in the syndicate, GVC backed portfolio companies do not face slower growth in employment and sales as well as lags in their innovative behavior compared to a matched sample of companies receiving independent VC (Bertoni & Tyková, 2015; Brander, Du, & Hellmann, 2015; Cumming, Grilli, & Murtinu, 2014). In light of their hampering effect on venture’s productivity, Alperovych, Hubner, and Lobet (2015) even go as far as calling for a ‘reexamination’ of the structure of governmental VC funds. In contrast, Luukkonen et al. (2013) stress that the value addition of public VC funds is not per se less than that of private VC investors. Rather, public and professional VC managers have different strengths in their value-adding behaviors.

Given the central role of knowledge in the internationalization process, we specifically focus on the perceived value addition of VCs with respect to this resource in this paper.

3. Knowledge in the Internationalization Process

International knowledge is generally regarded as generic construct (Park, LiPuma, & Prange, 2015). We decompose international knowledge used by young firms into four dimensions according to the typology developed by Lundvall and Johnson (1994). The detailed knowledge classification helps to structure the knowledge addition of VCs to their portfolio companies that is relevant for internationalization. In addition, it allows for the identification of specific areas where one type of investor might be more beneficial as external knowledge resource than another. Park et al. (2015) make use of the same classification to organize the existing literature on venture internationalization. In the following section, we elaborate how venture capital investors can contribute to each of the four knowledge components.
3.1. Know-what

Know-what refers to factual knowledge on foreign markets e.g. about competitors, business practices, customer needs and market conditions. It is often approximated by what is commonly described as ‘information’ (Foray & Lundvall, 1998). Know-what is gained through experience and learning. In the case of internationalization, the international exposure of actors, resulting from working or studying abroad, but also shorter time experiences abroad, such as trade fairs, trade missions and business trips, can increase the familiarity of actors with a foreign market and, in that, international know-what knowledge. Having a large stock of know-what insights into a foreign market, decreases managers perceived risk of pursuing an internationalization strategy (Eriksson, Majkgård, & Sharma, 2000).

During the past years, VC activity itself has become more global. A growing number of VCs, especially in Europe, has discarded their long persisting preference for choosing investment targets in their immediate neighborhood and has started to invest at further distances, crossing borders. In that way, VCs gain international ‘know what’, which facilitates the internationalization process of their target companies (Park et al., 2015). Examples of „know-what“ venture capitalists contribute to their portfolio companies include encouraging and informing them about foreign market conditions and potential market opportunities abroad.

3.2. Know-why

Know-why provides for the broader rationales behind venture internationalization. It refers to the reasons why the new venture is undertaking the efforts to expand its activities to a new market. It helps the entrepreneur realizing why entering a foreign market might be growth enhancing and worth to consider. ‘Know-why’ knowledge on internationalization can aid the new venture to recognize the need for the implementation of an international strategy as well as to discover international demand for its products.

Venture capitalists can elevate the need to internationalize by pointing out ways in which entering a foreign market will be beneficial to the growth of the young firm. The encouragement of a VC investor might diminish uncertainties on behalf of the entrepreneurs and encourage them to proceed with their internationalization ambitions (Park et al., 2015).

With respect to the strategy development (i.e. business plan, strategic focus, strategic capabilities) at the domestic level, Luukkonen et al. (2013) show that professional VCs are experienced by their portfolio companies as more value-adding than public VC managers.

3.3. Know-how

Know-how specifies the skills to conduct an activity. Know-how is mostly tacit in nature and is acquired through prior experiences. With respect to
internationalization, know-how e.g. includes process knowledge on how to enter a foreign market, identify important business partners, cope with legal, tax and institutional particularities, and set up a global supply chain.

A large stock of know-how is positively associated to a venture’s capability to internationalize. Given the fact that obtaining know-how is time consuming, due to its tacit nature and learning through experience, young firms often face a lack concerning this knowledge component. VCs may have gathered international experience during prior investments abroad or by having cooperated with foreign syndication partners. In that, they constitute valuable external sources of internationalization know-how (Park et al., 2015).

Luukkonen et al. (2013) compare the value-adding activities of independent and public VC sources. With respect to internationalization, they mainly concentrate on the know-how dimension. In their study, the perceived value addition of independent (private) venture capitalists [IVCs] and GVCs to international development overall is only small. Public VC investors score better than private funds in supporting the venture in marketing and distributing its product abroad, though the difference is not statistically significant. Same applies to the search for financing abroad and international recruitment, where the value-addition of IVCs appear higher, though the differences are also statistically insignificant. Only with respect to the recruiting of international board members, a statistically significant difference is observed between the two investor types, whereby IVC appears to be slightly more beneficial.

3.4. Know-who
Know-who is the knowledge to know ‘who knows what, and who knows who to do what’ (Foray & Lundvall, 1998). Thus, it is based on leveraging actor’s network relationships. It is also referred to as social capital. Know-who has been identified to facilitate internationalization by getting access to key stakeholders and employ their knowledge and skills. In addition, it also reinforces other knowledge dimensions, especially know-how and know-what.

Investors’ social capital can help portfolio companies to learn about foreign market opportunities, increase legitimacy among foreign stakeholders and reduce their “liability of foreignness” (Mäkelä & Maula, 2005). On the domestic level, IVCs are found to confer more credibility towards future investors than GVCs (Luukkonen et al., 2013).

4. Methodology (to be updated shortly)
A multiple case design is adopted in this study. Interviews with Belgian entrepreneurs that have received VC funding and pursue an internationalization strategy are currently in progress.

All companies in the sample were less than 6 years when they received their first VC round. Young firms are in larger need for VCs’ strategic advice than more mature companies, thus we focus on this group to interview. We focus the analysis on firms that are concentrating their business activities in the high tech
field and have not yet been acquired or went public. Moreover, the firm needed to be headquartered in the Belgian region of Flanders or Brussels in order to have been eligible for ARKimeses financing.

We focus on VC backed companies in Belgium. While the selection of the country scope is partly driven by convenience for the researcher to conduct interviews, Belgium is well suited for a comparison of independent and governmental VC funds as well as research on firm internationalization.

The largest public VC fund in Flanders is the ARKimeses fund. ARKimeses in turn invests in certified private VC funds, so-called ARKIVs. Every euro that gets invested by ARKimeses is at least doubled by the private investor. Investments in young and promising companies that are headquartered in the Belgian region of Flanders take place via the ARKIV. In that the Flemish government makes use of a fund-of-fund structure to distribute public VC. The current ARKimeses fund, ARKimeses fund II, disposes of 210 million Euro (2016). To facilitate internationalization attempts, the government raised the upper limit per round of investment from 1.5 million Euro to 20 million Euro per year in 2016.

### 4.1. Data Collection

We hand-collected a sample of VC data on public VC investments as commercial databases tend to focus on profession investment firms and their engagements and often lack precision with respect to early stage public involvements. We therefore retrieved data on public VC investments from the annual reports of the Flemish government agency that is responsible for public venture capital activities, ParticipatieMaatschappijVlaanderen (PMV), Crunchbase as well as company websites and news reports.

### 4.2. Method

To allow for previously disregarded or unnoticed themes to emerge, we use semi-structured interviews. The interviews lasted about 1 hour each. Interviews were taped (with the agreement of the participant) and transcribed directly in the aftermath of the data collection respecting the ‘24 hours rule’.

We validated the information retrieved from the interviews by triangulating our findings with secondary publicly available archival data sources such as databases, newspapers, press releases and information retrieved from the firms’ websites and other documents. If ambiguities maintained, we followed them up by additional email or phone communication with the interviewee.

### 5. Discussion (to be updated shortly)

### 6. Conclusion (to be updated shortly)
7. References


