



## Study on the Transnational Venture Capital Investments:

### A Theoretical Framework

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#### Abstract

Starting from reviewing the transnational venture capital investment phenomena, this article points out the necessity to study the transnational venture capital investment, and establish a theoretical framework about the research of the transnational venture capital investment. The framework is composed by the entry system that both investors and attractors find the values of the venture capital investment, the operation system of the venture capital investment and the exit system realizing the investment value, and these three systems are interdependent as well as relatively independent, and they reflect the generality and the particularity of the transnational venture capital investment, and they are also the uniform integer.

**Keywords:** Transnational venture capital investment, Investment motivation, Operation mechanism, Theoretical framework

#### 1. Research backgrounds and introduction

Since 1990s, with the development of the global economic integration, the internationalization tendency of the venture capital investment is more and more obvious, and the transnational venture capital investment has been the important part of the international investment activity.

As we all know, the venture capital investment has important drive function for the economic growth and technical advancement of one country. From 1995 to 2000, the financial amount of the global venture capital added from 44 billion dollars to 250 billion dollars, and the venture capital investment industry has been one of the industries with the quickest growth in the world, and the yearly average venture capital investment growth rate in seven most developed countries has achieved 42%. The venture capital investment has been the important channel of the national economic adjustment, especially for the high and new technology industry. The flow of the venture capitals in the national market drives the development of the transnational venture capital investment. In US where the venture capital investment industry develops most, from 1980s to the middle of 1990s, the proportion of the foreign venture capitals in the US venture capital investment amount was about 10%, and in 2000, this number achieved 26%. After 1990s, the amount that the venture capitals of developed countries flow to developing countries continually increased, for example, the foreign venture capitals flowing to India, China and Latin America presented the quick development tendency. In 2002, the proportion of the foreign venture capitals flowed to US is 20% of the whole venture capitals of US, and in the whole Europe, the venture capital flow among countries and foreign flow occupied 27% of the amount of the venture capitals, and in Asia, the transnational flow of venture capitals among nations and regions and foreign flow occupied 51% of the amount. These data indicated that the transnational venture investment had formed the scale through the quick development in the late of 1990s, and it has been a sort of new tendency for the international direct investment.

The practice of the transnational venture capital investment promotes the economic development and the technical advancement of various countries. This sort of investment activity has been concerned by some scholars who had issued some articles about the research of venture capital investment internationalization. But most of these researches are only limited in the factor analysis and development tendency about the transnational venture capital investment, and there are few foreign and domestic scholars to systematically study the transnational venture capital investment. The amount the international venture capital investment increases steadily and the process of the transnational venture capital investment is quickening gradually, so we should quietly emphasize the research about the transnational venture capital investment theory. For a series of problems about the transnational venture capital investment such as investment motivation, investment mode, operation mechanism, exit mode and the influences on the host countries, we urgently need to explain them in theory and summarize them in practice. So, aiming at above problems, this article tries to

establish a basic theoretical framework to systematically study the transnational venture capital investment behaviors.

## **2. Research view and literatures summarization**

The venture capital investment is a sort of equity investment, and it seeks the long-term investment incomes of the capitals, and it doesn't require the fluidity of the capitals, so it belongs to the direct investments. And in his article, we define the "transnational venture capital investment" as one sort of special form of the international direct investment. For the research about the transnational venture capital investment, we can start from the supply and demand relationship of the international venture capitals, and systematically study the capital operation process of the transnational venture capital investment based on the international direct investment theory.

About the research of venture capital investment, there are many systematic and special research results through tens years' developments, and they are relatively completed. But for a series of problems brought by the transnational factors, the traditional theory is hard to offer reasonable explanations, because the transnational venture capital investment possesses many characters such as high uncertainty and high risk. First, the transnational factors will bring added risks such as politic risk, exchange rate risk and high agency costs. Second, in the operation process of the venture capitals, the two-class agent problem exists, i.e. the agent relationships between investors and venture investors and between venture investors and venture enterprises, so the converse selection and moral risk will exist in the operations of venture enterprises because of asymmetric information. Third, as a sort of equity investment, the venture capital investment realizes the capital increment through the stock transfer, so the exit problem of the venture capitals possesses special characters. In fact, the research about the transnational venture capital investment is just rising in recent several years. Western scholars studies the transnational venture capital investment from the environment and mode of the venture capital investment, the cultivation about the supply and demand of the venture capitals, the decision factors and future tendency of the transnational venture capital investment, and the representative research results include following aspects.

Martin Kenney, Kyonghee Han and Shoko Tanaka (2002) summarized some characters of the transnational venture capital investment through reviewing the historical process of the international investment of the venture capitals. They thought that it depended on an acceptable environment which mainly included the commercial opportunity that allowed large capital to profit for the venture capitals to successfully implement transnational extension. In some countries which venture capital investment industry develops successfully, all governments have offered necessary assistances, which is the important factor to start the growth of the venture capital investment. Of course, the cultural traditions, social concepts and governmental regulations in some countries will baffle the developments of the venture capital investments, and they all need the government creates an advantaged environment. The environmental difference among countries may make the investment mode of the international venture capitals mix with the venture capital investment mode of the host country, and form the mode with the character of the host country. Therefore, the internationalization mode of the venture capital investment is mainly decided by the bilateral relationship.

Gompers and Lerner (2001) studied the internationalization of the venture capital investment from the supply and demand of the venture capitals. They thought that for each country which wanted to participate in the venture capital investment internationalization, it should emphasize the infrastructure construction of the venture capital investment, i.e. the cultivation about the supply and demand of the venture capitals. The supply of the venture capitals depends on three factors. (1) Investors' confidences. The venture capital investment will produce more return than other investments. (2) The fashion to support the venture capital investment. (3) The amount of the experienced venture investors who are in the business domain. The demand of the venture capitals depends on following conditions. (1) Regulated investment environment and legal structure. They should sweep the obstacles for the new enterprises and offer sufficient salaries for entrepreneurs. (2) Good investment basic structure, technical conditions and employee training to support the new enterprises and markets. (3) The cultural atmosphere to respect entrepreneurs' innovational spirits, especially for the venture spirits. (4) Healthy economic situation including thrifty IPO market. Gompers and Lerner advised that to promote the development of the venture capital investment, the government and national leaders have to emphasize the main factors influencing the supply and demand of the venture capitals and establish corresponding policy measures, and encourage the investment and attraction of the venture capitals.

Martin Haemmig (2003) firstly systematically studied the decision factors of the transnational venture capital investment on the layer of the enterprises. Haemmig analyzed the motivation and the strategy of the enterprise which engaged in the transnational venture capital investment, and described the decision factor of the venture capital investment internationalization. He thought that the "transferability" of employee, technology and capital decided that the new enterprise can be founded at any place in the world, and for the transnational venture capital investments, venture investors' experiences and talents are the key factors to decide whether the investment could be successful. When establishing the concrete strategies, then venture capital investment enterprises must consider many problems such as the industrial selection, the geographical location, the interior organization form of the company, the venture funds structure of the company, entrepreneur's salary and execution network because of the complexity of transnational

investment and the fixed risk of venture capital investment.

William L. Megginson (2004) studied the internationalization mode and the future development tendency of the venture capital investment. The modern venture capital investment industry rooting in US has been the important tool to drive the economic growth and technical advancement for various countries, but Megginson thought that the venture capital investment mode of US can not be simply copied to other countries, and it could not be the “international” venture capital investment mode. Though in recent years, the financing ability, investment mode and investment return of the venture capitals in the world presented the centralized tendency, but for whether the future venture capital investment industry could be go to real market integration, Megginson doubt that. He thought because of the differences of the investment environment such as the legal environment in different countries, the special “international” venture capital investment market composed by part of countries might occur.

From above introductions, we can see that the research about the transnational venture capital investment is mainly centralized in the summarization and the development tendency about the influencing factors of the venture capital investment internationalization. These results can help us to understand the development process of the transnational venture capital investment in theory, but the systematic research about the transnational venture capital investment still lacks. We think that the systematic characters of the transnational venture capital investment are mainly embodied in the investment motivation, the operation mechanism, the exit mode and the influences on the host country. And this sort of research method is consistent with the influencing degree of the development history of the venture capital investment to the society and the economy. At present, under the macro background of the global economic integration, the transnational flow of the venture capitals is gradually rising, and its influences are more and more obvious. But the relative researches are still trailed the practice of the transnational venture capital investment. First, the development history of the transnational venture capital investment is very short and its rule is hard to grasp. Second, the data about the transnational venture capital investment is difficult to be acquired, and its scientific research is limited. However, in theory, the systematic research is necessary, and it will offer theoretical guidance for the development of the transnational venture capital investment and bring important references for the academic references.

### **3. Theoretical framework about the transnational venture capital investment research**

As a sort of special investment mode of the international direct investment, the history of the transnational venture capital investment is very short, and it is only developed to be scaled investment in recent ten years. That is decided by the changes of the exterior conditions and interior factors of the venture capital investment. First, the development of the global economic integration process in recent ten years increasingly strengthens the international investment activities, which drives the transnational flow of the venture capitals. Second, the high-speed development of the scientific technology drives the demand for the international venture capitals and promotes the supply of the international venture capitals. So, to systematically study this economic phenomenon, we must base on the international direct investment theory.

In the international direct investment theory system, the monopolistic advantage theory, the internalization theory and the eclectic theory of international production occupy very important status. These theories mainly explain three problems about the international direct investment. The first one is the reason of the direct investment in foreign countries, i.e. why we invest in foreign countries. The second one is the condition of the direct investment, i.e. why we can invest in foreign countries. The third one is the object of the direct investment in foreign countries, i.e. where we invest in foreign countries. For the research about the transnational venture capital investment, we still emphasize the reason, condition and object of the transnational venture capital investment. However, the international direct investment theory still can not explain all peculiarities of the transnational venture capital investment, and we have to utilize other economics theories to study the problem. Based on that, we can primarily establish a theoretical framework about the research of the transnational venture capital investment.

First, the transnational venture capital investment theory should explain following three problems. The first problem is the reason of the transnational venture capital investment. The transnational flow of the venture capital investment requires that investor's investment motivation is consistent with the attractor's attraction motivation, and find the potential values of the invested venture enterprise and produce the transnational venture capital investment behavior through the link with the venture entrepreneur. The second problem is the operation condition of the transnational venture capital investment. Through eliminating the limitation of the transnational investment and reducing the entry bulwark, investors and attractors can establish effective operation mode according to both conditions, and create values for the invested enterprise through the service increment offered by venture entrepreneur. The third problem is the exit environment of the transnational venture capital investment. The exterior environment of the investment should ensure the venture capitals can exit at proper moment to realize their values, so the investor realizes the increment of the capital and the attractor realizes the extension of the capital.

Second, to systematically study the transnational venture capital investment, we must establish organic association between the transnational investment system of the investment country and the transnational attraction system of the

invested country. As viewed from the capital operation characters of the transnational venture capital investment, above three problems basically contain the basic process of the venture capital investment, i.e. the investment, the operation and the exit of the venture capital. So we can divide the total framework of the transnational venture capital investment theory into three systems. The first system is the value discovery process of the venture capital investment object, i.e. the process translating the investment (attraction motivation) into behaviors, and we call it as the entry system. The second system is the capital increment process of the venture capital investment, and it creates values for the operation and management for the venture enterprise through the investors and the attractors, and we call it as the operation system. The third system is the value implementation process of the venture capital investment, and it realizes the high capital increment and income through the exit of the venture capitals in the special environment, and we call it as the exit system. The theoretical framework system about the research of the transnational venture capital investment is seen in Figure 1.

In the framework, the entry system, the operation system and the exit system embody the generality and the particularity of the transnational venture capital investment. The final aim of the transnational investment of the venture capitals is to realize the increment of the capital. And to achieve this aim, it must experience the basic process including discovering investment value, creating investment value and realizing investment value, and the process embodies the generality of the transnational venture capital investment. Because the transnational venture capital investment possesses many characters such as high uncertainty and high risk, so we should adopt more scientific method to make right decisions in many aspects such as the investment object selection, the item risk evaluation, the management team reputation investigation and the location selection. The entry mode and the investment mode of the transnational venture capital investment have their own characters, and especially the management increment service offered by the venture entrepreneur makes the operation mechanism of the transnational venture capital investment be differing from general international direct investment. The transnational venture capital investment needs realizing the high capital increment income through the capital exit, so the venture enterprise has special requirement for the exit environment of the capitals, which also reflects the particularity of the transnational venture capital investment. The entry system introduces the increment channel for the venture capitals, and the operation system offers the increment condition for the venture capitals, and the exit system ensures the increment aim for the venture capitals, so these three systems are interdependent as well as relatively independent.

#### 4. Conclusions

Based on the international direct investment theory, we study the basic problems about the transnational venture capital investment, seek the combination point of the international direct investment theory and the venture capital investment starting from analyzing the characters of the venture capital investment, and establish the theoretical research framework of the transnational venture capital investment. To systematically research the transnational venture capital investment, we should depend on the analysis and method application of key problems in every subsystem such as the investor's motivation and the attractor's motivation research, the project risk evaluation and the decision-making behavior research in the entry system, the contract arrangement research of the venture capital investment and the function research of venture entrepreneur in the operation system, and the exit environment research and the exit mode research in the exit system. For the concrete research methods, we should further explore.

In a word, the theoretical research framework of the transnational venture capital investment establishes a complete system on the theoretical layer and on the operation layer. This system starts from the internationalization phenomenon of the supply and demand relation of the venture capitals and takes the transnational investment (attraction) motivation, operation and exit as factors to establish the mutual association mechanism between transnational investors and transnational attractors, takes the value discovery, value creation and value implementation of the venture capitals as the routes to establish the transnational venture capital investment research theoretical system through the organic unification of the three systems including the entry system, the operation system and the exit system, and it offers a new idea for us to study the transnational venture capital investment.

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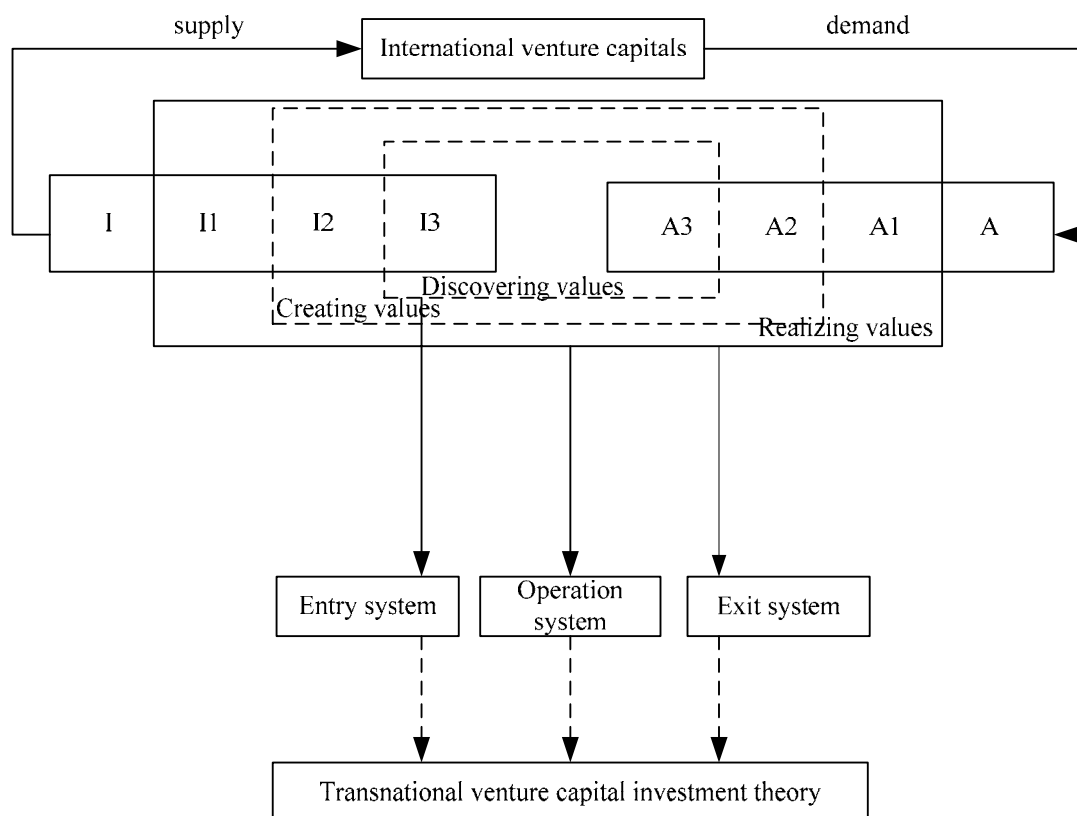


Figure 1. Theoretical Framework of the Transnational Venture Capital Investment Research

Note: I: Transnational investment system, I1: Investment exit, I2: Investment operation, I3: Investment motivation, A: Transnational attraction system, A1: Attraction extension, A2: Attraction operation, A3: Attraction motivation.