

4.8: Venture Capital and the Global Capital Markets

Learning Objectives

1. Understand the impact of the global capital markets on international business through the expansion of international venture capital.
2. Understand international venture capital.
3. Understand the perspective of international venture capitalists.

Every start-up firm and young, growing business needs capital—money to invest to grow the business. Some companies access capital from the company founders or the friends and family of the founders. Growing companies that are profitable may be able to turn to banks and traditional lending companies. Another increasingly visible and popular source of capital is venture capital. Venture capital (VC) refers to the investment made in an early- or growth-stage company. **Venture capitalist** (also known as VC) refers to the investor.

One of the unintended benefits of the expansion of the global capital markets has been the expansion of international VC. Typically, VCs establish a venture fund with monies from institutions and individuals of high net worth. VCs, in turn, use the venture funds to invest in early- and growth-stage companies. VCs are characterized primarily by their investments in smaller, high-growth firms that are considered riskier than traditional investments. These investments are not liquid (i.e., they cannot be quickly bought and sold through the global financial markets). For this riskier and illiquid feature, VCs earn much higher rates of return that are sometimes astronomical if the VC times the exit correctly.

One of the factors that any VC assesses while determining whether or not to invest in a young and growing company is the **exit strategy**. The exit strategy is the way that a VC or investor can liquidate an investment, usually for a liquid security or cash. It's great if a company does well, but any investor, including VCs, wants to know how and when they're going to get their money out. While an initial public offering (IPO) is certainly a lucrative exit strategy, it's not for every company. Many VCs also like to see a list of possible strategic acquirers.

Did You Know?

Many large global firms also have internal investment groups that make corporate venture investments in early-stage and growing companies. These corporate VC firms may actually be the exit strategy and eventually acquire the young company if it fits their business objectives. This type of corporate VC is often called a strategic investor because they are more likely to place a higher priority on the strategic value of the investment rather than just the pure financial return on investment.

For example, US-based Intel Corporation, one of the world's largest technology companies, has an internal group called Intel Capital. The vision of Intel Capital is "to be the preeminent global investing organization in the world" and its mission "to make and manage financially attractive investments in support of Intel's strategic objectives." "Intel Capital," Intel Capital Corporation, accessed March 2, 2011, <http://www.intel.com/about/companyinfo/capital/index.htm>.

Intel Capital makes investments in companies around the world to encourage the development and deployment of new technologies, enter into or expand in new markets, and generate returns on their investments. "Since 1991, Intel Capital has invested more than USD 9.5 billion in over 1,050 companies in 47 countries. In that timeframe, 175 portfolio companies have gone public on various exchanges around the world and 241 were acquired or participated in a merger. In 2009, Intel Capital invested USD 327 million in 107 investments with approximately 50 percent of funds invested outside the U.S. and Canada." "About Intel Capital," Intel Capital Corporation, accessed March 2, 2011, www.intel.com/about/companyinfo/capital/info/earnings.htm.

Table 7.2 shows a sample of the global investments made by Intel Capital.

Table 7.2 Intel Capital Investments Announced in November 2010

Company	Country	Business
Althea Systems	India	Makes a cloud-based video platform to find and share online videos across devices (Shufflr is its social video browser)
Anobit	Israel	Memory signal processing technology

Company	Country	Business
Boo-box	Brazil	Software-based ad system for social media
De Novo	Ukraine	Provides enterprise-class data centers and services in Ukraine
Iptego	Berlin	Makes software to optimize Next Generation Networks
Layar	Netherlands	Reality platform available on Android, iPhone, and Bada mobile devices
Rock Flow Dynamics	Russia	Makes modeling software that simulates fluid and gas filtration
Select-TV	Malaysia	Makes set-top boxes for IP TVs
Taifatech	Taiwan	Fabless semiconductor company that makes wireless system on a chip
WinChannel	Beijing	Makes software that manages replenishment orders, sales, inventory, and other activities in near-real time

Source: Copyright Intel Capital, 2010.

As a result, the expanded global markets offer VCs access to (1) new potential investors in their venture funds; (2) a wider selection of firms in which to invest; (3) more exit strategies, including IPOs in other countries outside their home country; and (4) the opportunity for their portfolio companies to merge or be acquired by foreign firms. Tech-savvy American and European VCs have traced the source of the high-tech talent pool and increased their investments in growing companies in many countries, including Israel, China, India, Brazil, and Russia.

Did You Know?

A July 2010 research survey conducted by Deloitte uncovered the following sentiments among VCs from around the world.

‘Traditionally strong markets like the U.S. and Europe will continue to be important hubs despite consolidation in the number of venture firms,’ said Mark Jensen, partner, Deloitte & Touche LLP and national managing partner for VC services. ‘However, the stage has now been set for emerging markets like China, India and Brazil to rise as drivers of innovation as they are increasingly becoming more competitive with the traditional markets.’...

Overall, only 34 percent of all respondents indicated that they expect to increase their investment activity outside their own country....The countries with the most interest in cross border investing include: France (56 percent), Israel (50 percent) and the United Kingdom (49 percent). Countries indicating the least interest in outside investing were Brazil (19 percent), India (15 percent) and China (11 percent).

‘The Asian markets, in particular, are abundant in entrepreneurial spirit, energy and a dedication from both the private and public sectors to push the economic growth pendulum as far as possible,’ said Trevor Loy, general partner of Flywheel Ventures. ‘The continued rapid growth of emerging markets is also creating a new source of customer revenue, investment capital, job creation, and shareholder liquidity for U.S. based technology start-ups, particularly those leveraging America’s deep research and development (R&D) resources to address critical infrastructure needs in energy, water, materials and communications.’...

Top challenges varied in countries around the globe with the exit market being cited the most in the United Kingdom (80 percent), Canada (75 percent), India (71 percent) and Israel (70 percent). Eighty-one percent of respondents in Brazil cited unfavorable tax policies as being a hindrance. An unstable regulatory environment was the most common factor cited by respondents in France (72 percent) and China (62 percent).

‘The challenges for a U.S. venture firm trying to do business in Europe include the current weakness in the euro-zone economy, language and cultural differences, and the tendency towards inflexible employment regulations,’ said Bruce Evans, managing director of Summit Partners. ‘On top of this, U.S. firms have to fund their European expansion from their own profits, and the

proposed U.S. tax changes to carried interest—and the taxation of equity interests in fund managers more generally—would serve as an impediment to U.S. venture funds’ growth aspirations.’

‘Yet, opportunities remain as well,’ Evans continued. ‘The psychological make-up of successful, driven entrepreneurs in Europe mirrors what we have found in the U.S. In addition, the globalization of technology markets means that successful products are as likely to be developed in Europe as elsewhere. Finally, the days of missionary selling of venture capital in Europe are over, and today there is a broad understanding of our type of financing.’ “U.S. Venture Capital Industry Expected to Shrink While Emerging Markets Grow: Deloitte, NVCA Study,” Deloitte Corporation, July 14, 2010, accessed February 2, 2011, www.deloitte.com/view/en_US/us/Insights/browse-by-role/media-role/a8e40f2f800d9210VgnVCM200000bb42f00aRCRD.htm.

Key Takeaways

In this section, you learned

1. VC is the investment made by an investor in an early- or growth-stage company. *Venture capitalist* (also known as VC) refers to the investor. Typically, VCs establish a venture fund with monies from institutions and individuals of high net worth. Venture capitalists, in turn, use the venture fund(s) to invest in early- and growth-stage companies.
2. VC investments are characterized primarily by the fact that they invest in smaller, high-growth firms that are considered higher risk than traditional investments and that the investments are not liquid—that is, they cannot be quickly bought and sold through the global financial markets. For this riskier and illiquid feature, VCs earn much higher rates of return that are sometimes astronomical if the exit is timed correctly.
3. One of the key factors that any VC assesses while determining whether or not to invest in a young and growing company is the exit strategy. The exit strategy is the way a VC or investor can liquidate investments, usually for a liquid security or cash. As a result, the expansion of the global capital markets has benefited VCs who now have more access to the following:
 - New potential investors in their venture funds
 - A wider selection of firms in different countries in which to invest
 - More exit strategies, including IPOs, in other countries outside their home country and the opportunity for their portfolio companies to merge or be acquired by foreign firms

EXERCISES

(AACSB: Reflective Thinking, Analytical Skills)

1. Why do VCs benefit from increased globalization? List three reasons. If you were a research analyst at a US-based VC firm, what would you recommend to your senior partners about the global market opportunity?
2. What is an exit strategy? Why is it so important to a VC?

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