

***An analysis of South African venture capital practitioners' views on the motivations,
benefits and constraints of international syndication.***

A research report

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Abstract

The international syndication of venture capital investments has become an increasingly widespread phenomenon, but there is a lack of research which applies the already limited prior international research in this field¹ to South Africa or other African countries. This research aims to begin that discussion, and take the first step in filling that gap of understanding. The main research questions addressed in this study: are local venture capital practitioners ready and willing to syndicate internationally, and what are the constraints to the formation of those transactions? The issues were examined by interviewing high level investment practitioners representing seven of the 21 non-governmental VC firms belonging to the South African Venture Capital Association (SAVCA). This data were influenced and shaped by other available sources of primary and secondary data. The results indicate that South African venture capital investors are ready and willing to syndicate internationally, however there are caveats to that broad statement which the ensuing analysis addresses. Additionally, it was found that there are significant and profound constraints to these transactions forming in South Africa. Those constraints are an unsupportive regulatory environment, negative perceptions by the international investor community of South Africa, small domestic deal sizes and the dearth of bankable ventures led by high quality management teams. Options for further research include a study of the attitudes of potential foreign VC professional partners to the option of syndication involving South African VC firms, and a more in depth investigation into the risks and constraints to South Africa-international syndication.

¹ The international research on venture capital syndication mainly speaks to the benefits and driver of venture capital syndication, and not so much to the readiness of the venture capital of a specific country to syndicate. See Schertler & Tykova (2012), Makela & Maula (2005), Makela & Maula (2008), Hursti & Maula (2007), and Jaaskelainen & Maula (2005) for examples of key studies related to the above.

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List of Acronyms

ANC	-	African National Congress
AUM	-	Assets Under Management
BBBEE	-	Broad Based Black Economic Empowerment
BEE	-	Black Economic Empowerment
BRIC	-	Brazil, Russia, India and China
CSIR	-	Council for Scientific and Industrial Research
DFI	-	Developmental Finance Institution
DTI	-	Department of Trade and Industry
FDI	-	Foreign Direct Investment
GEM	-	Global Entrepreneurship Monitor
IDC	-	Industrial Development Corporation
IP	-	Intellectual Property
IPO	-	Initial Public Offering
IRR	-	Internal Rate of Return
JSE	-	Johannesburg Stock Exchange
JVCC	-	Johannesburg Venture Capital Club
M&A	-	Mergers & Acquisitions
NVCA	-	National Venture Capital Association
SARB	-	South African Reserve Bank
SAVCA	-	South African Venture Capital Association
SBDC	-	Small Business Development Corporation
SME	-	Small and Medium Sized Enterprise
SSA	-	Sub-Saharan Africa
TEA	-	Total Entrepreneurial Activity
UNCTAD	-	United Nations Conference on Trade and Development
VC	-	Venture Capital
WIE	-	Weak Institutional Environment

1 Introduction

1.1 Background

The venture capital² industry in South Africa is nascent, and that may be a generous description. The funds and investment companies which do purport to operate in the space make few investments, often have limited track records, and as a whole have yet to exhibit a sustained ability to generate returns and results for investors. Providing support for those statements are data from a 2012 report (SAVCA & Venture Solutions, 2012) which showed that from the years 2009 to 2012 there were a total of 103 venture capital investments with a total value of ca. USD 83mn³. As a point of comparison, in 2012 alone the US had 3,698 venture capital transactions with a total value of ca. USD 26.5bn (PWC & NVCA, 2013).

Local researchers have assessed the industry and its deficiencies, and their analyses (Jones, 2009; Lingelbach et al., 2009) provide fodder for this research as it unpacks one important potentially ameliorative phenomenon, that being the international syndication of venture capital investments⁴ in South Africa.

When investing in ventures abroad, complexities arise due to different legislations, languages, cultures and long distances between the investors and portfolio companies (Makela & Maula, 2006; Fritsch & Schilder, 2008). The complexities, or *liabilities of foreignness*, are often amplified with early stage investments due to the inherent need of those investments for more support and guidance, relative to larger private equity deals which typically invest into much more established and profitable businesses (Clarysse et. al, 2007; Zahra et al., 2007). To deal with these complexities, international syndicates are sometimes formed. Having a strong local investor in the consortium is important as they can more effectively monitor the investment, and provide other support which could

² Venture capital, for purposes of this research, is defined as it is defined in the 2012 SAVCA Venture Solutions VC Survey. That definition is that it is “a subset of the private equity asset class which deals with predominantly equity funding of high tech, high growth-potential businesses, whose growth is typically achieved through radical global scaling. The need for venture capital stems from the specific requirements of such businesses in the start-up and early growth phases, and the part that experienced venture capital fund managers can play in structuring and nurturing investments into these businesses.”

³ Assuming a 10 to 1 exchange rate with the South African Rand.

⁴ Throughout this research report and in other research in this field, international syndication and investing are also referred to as cross-border syndication and investing.

otherwise be too expensive to provide from afar (Wright & Lockett, 2003; Makela & Maula, 2008; Sapienza, 1992).

Internationally syndicated venture capital investments are in theory simple transactions. The parties involved are a foreign investor, co-investing with a local investor⁵ into a local venture and/or management team. The benefits, drivers, roles and risks of these transactions have received some recent attention, and those findings are outlined in the literature review in Chapter 2. For South African early-stage investors and entrepreneurs, understanding how these transactions work and how they can be facilitated are important, and the stakes are high. With international investment comes a quick transfer of risk capital and specialized skills from the developed world (Patricof, 1989; Barry, 1994; Bygrave & Timmons, 1999). The international investors also benefit. From their perspective, investing in the South African venture capital asset class is a way to increase geographic diversity in their portfolios to reduce systematic risk, and to increase yields. The increase in yields is possible by higher growth rates and reduced levels of competition in many developing markets, like South Africa. A properly structured internationally syndicated venture investment can be a win-win proposition for all parties involved.

A major research gap exists in relation to academic analyses which deal with crossing of country borders by venture capital firms (Wright et al., 2005). This research takes steps to further close that gap in the international research, and is the first attempt known by this researcher to do so in a South African (or African) context. To begin the discussion and analysis of South Africa's venture capital ecosystem and its suitability for internationally syndicated venture investments, the main research questions addressed in this study: are local venture capital practitioners ready and willing to syndicate internationally, and what are the constraints to the formation of such transactions?

The issues are critically examined firstly by interviewing a significant proportion of the total population of venture capital practitioners in South Africa. The questions posed, and interview structure utilised, were heavily influenced by the existing body of international

⁵ In the case of this research, the local investors and ventures are always South African, and the foreign investor from any other markets outside of South Africa.

research in the field. Other non-original secondary and primary data were used to shape the discussion, frame the issues, and to draw and support conclusions.

1.2 Aims and Objectives

A review of the literature shows that there are several benefits of international syndication to both the venture and the investors. It's likely that internationally syndicated venture transactions, if properly structured, would benefit South African ventures and investors. The purpose of this research is to assess why these transactions aren't more common, and to identify whether the local venture capital investors are ready and willing to syndicate internationally, and the constraints in South Africa which may be hindering these transactions.

1.3 Layout of the Research Report

The research report is set out as follows: Chapter 2 is the literature review that describes the relevant theories of syndication, and in particular, international syndication. Chapter 3 describes the history, body of academic literature and current state of the South African venture capital industry. Chapter 4 defines and defends the research methodology that was used. Chapter 5 presents the results. Chapter 6 discusses the results. Chapter 7 presents the conclusion. Chapter 8 discusses recommendations for future research, and Chapter 9 offers policy suggestions.

2 Venture Capital industry in South Africa

2.1 Introduction

The South African venture capital industry can be traced formally back to the 1980s with the formation of the Johannesburg Venture Capital Club (JVCC) in Johannesburg, South Africa. Since then, the industry has weathered several storms, including economic isolation over global protests to apartheid, the overthrowing of that government and formation of a new democratically elected government, the global financial crisis beginning in 2008 and other significant events. The history, current state, and available literature on the South African venture capital industry is described in this chapter.

2.2 History of venture capital in South Africa

Table 1: History of venture capital in South Africa

Date	Event
1940	IDC established to fund SMEs and combat poverty in the Afrikaans community
1981	Business Partners Ltd founded to develop and fund SMEs in Southern Africa
mid-1980s	JVCC established
1990	JVCC fails
1992	Technifin venture capital fund launched
1994	Newly elected ANC dedicates itself to supporting SMEs
1999	Department of Trade and Industry drafts a national venture capital programme
2008	Global financial crisis (AUM in venture capital industry from ZAR 2.6bn in 2007 to ZAR 700mn in 2009)

(Sources: Lingelbach et al. (2009), Technifin website, 2012 Business Partners annual report)

A concise history of the venture capital industry in South Africa is proffered by Lingelbach et al. (2009) in *The Rise and Fall of South African Venture Capital: A Coproduction Perspective*. In that, the researchers describe the widespread interest in venture capital in South Africa beginning in the mid-1980s with the establishment of the Johannesburg Venture Capital Club (JVCC). The JVCC was led by a South African who was inspired after a visit to the United States and witnessing business plans being presented to a venture capital club there. The club received support from prominent local law firms, private equity managers, the

Industrial Development Corporation (IDC) and Business Partners. It ultimately died out by 1990.

The first formal venture capital fund in South Africa was Technifin, and was founded in 1992. Technifin was a joint venture between two state-controlled organizations, the IDC and the Council of Scientific and Industrial Research (CSIR). The fund focused on commercializing technologies and IP residing in South Africa. Technifin technically failed in the late 1990s, but is still operating as of October, 2013, and primarily licenses IP held in its portfolio to domestic and international parties.

Interestingly, Lingelbach et al. (2009) describe that the development of venture capital in South Africa has historically been linked to the government's desire to support small and medium sized enterprises (SMEs). Post-apartheid, this support has come largely to foster black economic empowerment (BEE) initiatives and to encourage previously disadvantaged racial categories or peoples in South Africa to start and run businesses. For example, the iMbewu Fund, administered by the National Empowerment Fund, aims to provide entrepreneurial and expansion funding to black-owned businesses in the range of ZAR 250,000 – ZAR 10,000,000.

Lingelbach et al. (2009) go on to describe that towards the end of apartheid, ownership and assets were becoming increasingly concentrated in most sectors, thus squeezing out many entrepreneurs, whether they be black, white or other. In 1994, partially in response, the newly elected African National Congress (ANC) party sought to combat the concentration, and dedicated itself to providing SME financing to South African businesses. The government focused on greater fiscal prudence, easing monetary policy, and encouraging private investment. Due to these and other factors, the economy experienced sustained growth.

In 1999, the Department of Trade and Industry (DTI) drafted a national venture capital programme which had four recommendations: 1) develop and maintain a venture capital infrastructure, 2) encourage and assist entrepreneurs, 3) direct government supported research and development, and 4) increase the availability of seed and early-stage capital

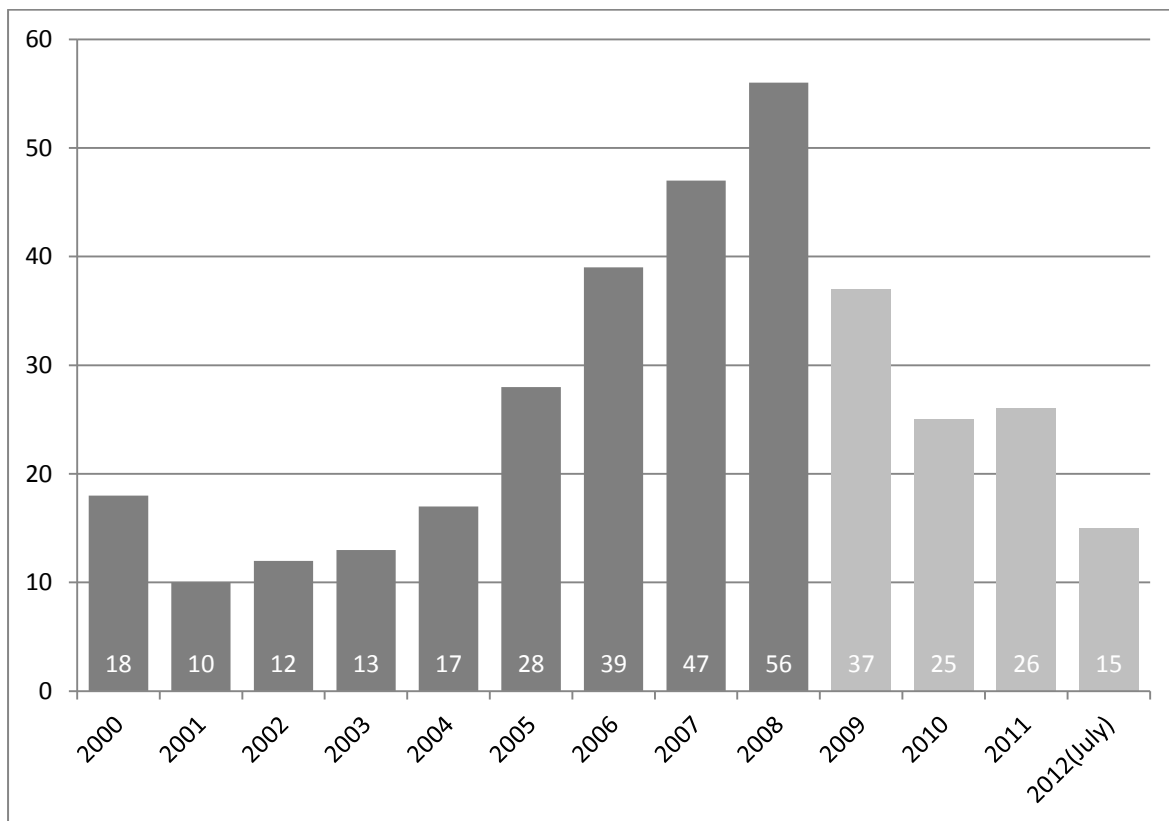
through the establishment of five venture capital funds modelled on the Australian Innovation Investment Fund (IIF), and the encouragement of an active angel network. Though not a slam dunk, these resolutions were helpful, and since then the IDC has been the primary government funded provider of entrepreneurial capital to South African businesses.

According to Lingelbach et al. (2009) it is unclear what progress has been made vis-à-vis the South African government's support of entrepreneurialism and venture capital. There has been virtually no formal evaluation of these initiatives, but the general informal consensus is that they have not been successful. Lerner (2012), in a book titled, *Boulevard of Broken Dreams: Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed – and What to Do About It*, may offer some guidance. In that he makes a strong case why government is not well equipped to make investment selection decisions, and what roles they should and can credibly play. South Africa's attempts to help the local ecosystem largely fall into categories which Lerner deem unfit for government participation, and may ultimately have caused more harm than good.

Since the company's founding, the primary provider of entrepreneurial capital from the private sector is Business Partners Ltd. Business Partners was founded in 1981, and is a company which sprung from the Small Business Development Corporation (SBDC). It is approximately 20% owned by the South African government. According to the 2012 Annual Report, since its founding, Business Partners has helped finance more than 69,000 businesses, with total investments of ZAR 12.5bn.

The most recent notable event impacting the South African venture capital industry is the global financial crisis. This table, a replica from the 2012 SAVCA Venture Solutions VC Survey shows where the industry was in terms of venture capital transactions leading up to the financial crisis, and what happened in the ensuing years.

Table 2: Transactions per year in South Africa, from 2000-2012 (Q2)



(Source: 2012 SAVCA Venture Solutions VC Survey)

Portman et al. (2013) offer good commentary when explaining the effects of the 2008 global financial crisis on the South African private equity and venture capital industries. Citing the KPMG & SAVCA 2010 industry report, Portman explains that from 2007 to 2009 private equity activity decreased from ZAR 2.6bn in 2007 to only ZAR 0.7bn in 2009. He concludes that early-stage investors were hurt the worse, relying on a 2009 Deloitte and SAVCA confidence survey of South African private equity practitioners which found that less than 5 percent of those interviewed were investing in early-stage ventures in 2009, down from 40 percent in 2005. This conclusion was corroborated by a subsequent KPMG & SAVCA 2010 report which showed that seed, startup and early-stage investments in South Africa declined from ZAR 1.134bn in 2008 to only ZAR 280mn in 2009. This table shows the figures Portman et al. (2013) used to tell that story:

Table 3: Effects of financial crisis on SA private equity and venture capital

	2005	2007	2008	2009	Total Decrease
Startup and seed investment totals (ZAR)			1.134bn	0.28bn	-75%
Total Private Equity activity (ZAR)		2.6bn		0.7bn	-73%
Percent of investors investing in early-stage ventures	40%			5%	-88%

(Sources: 2005 and 2009 Deloitte and SAVCA confidence surveys, and KPMG & SAVCA 2008 and 2010 industry reports)

2.3 Current state of venture capital in South Africa

South Africa's venture capital investment activity has recovered slightly from the aforementioned 2009 figure of ZAR 280mn. In 2012, the private equity industry had ZAR 10.6bn worth of transactions, and 9.3% (or ZAR 1.04bn) of those were in the early-stage, seed and startup category (KPMG & SAVCA, 2013). To put that in perspective, before the global 2008 financial crisis, the venture capital industry in South Africa had transactions worth ZAR 0.59bn and ZAR 0.9bn in 2005 and 2006, respectively (KPMG & SAVCA, 2006). Note from the table below the decrease in percentages of private equity investments attributable to early-stage and seed investments from 15 percent in 2006 to 9 percent in 2012.

Table 4: South African venture capital activity, now and then

Year	Private Equity Activity (ZAR)	% attributable to early-stage and seed investments	Early-stage and seed activity (ZAR)
2012	10.6bn	9%	668mn
2006	6bn	15%	585mn
2005	4.5bn	13%	900mn

(Sources: 2006 and 2013 KPMG & SAVCA industry reports)

Business Partners remains an important and influential provider of startup and expansion capital to South African entrepreneurs. In 2012, the company made 320 (66.1% of total)

investments, with an average deal size of ZAR 1.92mn (KPMG & SAVCA, 2013). This represents a substantial portion of all early-stage investments in South Africa. Business Partners has also recently embarked to fund more high-growth and riskier ventures with more upside potential through a recently established proprietary venture capital fund which it calls the *Venture Fund*. As of October, 2013 the fund was sitting on ZAR 400mn of committed capital, and had made zero investments.

An additional point to mention is that, although widely seen to be favourable to private equity investment in general, the recent changes to Regulation 28, which in South Africa regulates the asset class allocations of pension funds, are not likely to have any material effect on the local VC industry. Whereas Regulation 28 previously did not clearly stipulate maximum private equity allocation for pension funds, the revised version effective from 2011 allows for investment in private equity of up to 10% of pension fund assets under management. However, given the very high risk of venture capital investments, it is extremely unlikely that South African pension funds, who are already quite risk averse, will invest in this asset class anytime soon.

2.4 Academic literature on the South African industry

There is a limited body of research on the venture capital industry in South Africa, and none of significance dealing with other African countries which this researcher could find. All of the research known to this researcher dealing with the South African venture capital ecosystem is briefly summarized herein. Although not directly relevant to this research on international syndication, many of the findings from prior research are edifying.

A longitudinal case study of the South African venture capital industry was conducted by Lingelbach et al. (2009) titled, *The Rise and Fall of South African Venture Capital: A Coproduction Perspective*. The data sets used to draw conclusions were from interviews, direct observations, and prior academic and industry research. By looking at the venture capital industry's rise and fall (as they termed it) from 1980 to 2008, they shed light on what

causes venture capital to thrive in countries with weak institutional environments (WIEs) where regulatory barriers are high and property rights insecure.⁶

The *simultaneity explanation* of venture capital emergence states that the industry springs to life when three factors are sufficiently present: pools of capital, specialized financial institutions and entrepreneurs (Gilson, 2003). In South Africa, the researchers argued that post-apartheid, all three of these conditions were present yet the venture capital industry collapsed. *Coproduction* was the model these researchers created through which to analyse and understand the South African industry, and this model looked largely at the relationship between government actors and entities, and venture capital practitioners. They argued that this model was appropriate for South Africa, a country where the government was largely responsible for providing seed capital and funding activities which would otherwise be funded through private actors in more developed economies. They attributed the collapse in the local venture capital industry to weakening ties (or embeddedness) between the private sector (mostly white) and public sector (mostly black) actors, post-apartheid.

That same year, Lingelbach (2009) also looked at the South African venture capital industry in, *Neither Pirates nor Politicos: The Emergence of Venture Capital in Weak Institutional Environments*. Chapter 4 of that research deals exclusively with South Africa's venture capital market, and delivers the findings in a case study format. In that, he discusses the aforementioned *coproduction perspective* of venture capital emergence in South Africa, and describes the industry (including the private equity industry) and state of information in 2008 and before quite thoroughly. Interesting and edifying comparative data are presented showing the state of other emerging market venture capital industries, relative to South Africa.

Van Deventer (2009), published a piece in the South African Journal of Business Management titled, *Factors influencing venture capitalists' project financing decisions in South Africa*. The study explored and identified the investment criteria used by South African venture capitalists in their venture screening and evaluation processes. A Lickert

⁶ South Africa was considered a WIE in Lingelbach's research.

scale questionnaire was used to gather the data from which conclusions were drawn. It was found that South African venture capitalists consider the entrepreneur's honesty and integrity, a good expected market acceptance, and a high IRR to be the three most important criteria.

The questionnaires were sent to the 16 SAVCA members who qualified as venture capital firms under their definition, and 12 completed surveys. Essentially, this was the same questionnaire which has also been administered in the US and Europe in prior studies. It was concluded that the South African and foreign venture investors are similar in how they make venture project finance decisions.

In 2013, as a follow-up study to Van Deventer (2009), Portmann published a piece in the South African Journal of Economics and Management Sciences titled, *Private Equity and Venture Capital in South Africa: A Comparison of Project Finance Decisions*. An important difference between the two is that Portmann's research is post-financial crisis of 2008, and includes private equity firms in the sample. As expected, both venture capital and private equity firms rate the entrepreneurs and management team higher than other criteria, and private equity firms rely more on financial data which is usually not available to venture capitalists. The data found a strong shift in focus away from start-up funding and towards later-stage deals, indicating a decline in risk appetite among local money managers since the 2008 study on the venture capital industry.

Lastly, a working paper by Jones (2009) titled, *Early-stage venture capital in South Africa: Challenges and prospects*. The aim of that research was to assess the factors which impact the development of early-stage venture capital in South Africa. The researchers used an online survey, and interviews as sources of data. The key factors identified which needed attention were lack of funds targeting early-stage investments, lack of specialised fund managers, and low entrepreneurial skillsets in South Africa. Recommendations included engaging more with angel investors and improving cooperation between the different market players in the sector.

The research at hand builds upon the prior academic research into the South African venture capital industry by firstly offering a pragmatic analysis of a possible solution to the problems which the other researchers on South Africa's venture capital industry have highlighted with aplomb. This is the first research in South Africa on a possible ameliorative solution in the local ecosystem, and also the first research on the local ecosystem through an international investment lens. There is a burgeoning body of academic literature coming out of several countries which describes the relatively young phenomenon of the international syndication of venture investments, and this piece is the first to incorporate that literature into a South African context. In so doing, this research fills gaps both in the South African research, and in the international body of research around international syndication.

3 Literature Review on Domestic and Cross-Border Venture Capital Syndication

3.1 Introduction

The following literature review defines syndication in a venture capital context, and discusses the benefits, drivers and other features of this phenomenon. Also discussed are the unique benefits, drivers, constraints, risks and party roles in internationally syndicated venture capital transactions.

3.2 Syndication in general (domestic and international)

Venture capitalists often co-invest with one another, much like bankers syndicate commercial loans. In the venture capital context, syndication is where two or more venture capitalists take an equity stake in an entrepreneurial venture with the expectations of collaborating to produce a joint payoff (Wilson, 1968). Early research on returns of syndicated investments in the US show that over 50% of all venture capital investments are syndicated, and often with one investor playing the part as lead investor which usually entails shouldering the bulk of the monitoring and support functions (Wright & Lockett, 2003). A more recent study in 2009 by Dimov and Milanov found that in 2,498 venture capital investments in the US from 1980 to 2004, 73% of those first round investments were syndicated. In Europe, the typical rate of syndication is between 40% and 50%, with the UK

having a lower than normal rate of only 18% in 2001 (Manigart et al., 2006; Wright & Lockett, 2003).

Syndication by venture capital firms is based on a desire to share and to reduce risks (Lockett & Wright, 2001; De Clercq & Dimov, 2004). Sharing of risks involves including other investors through syndication at various stages of the investment (Lockett & Wright, 2001). Risks are reduced through sharing information, and including investors who increase the likelihood of success of the venture (Lockett & Wright, 2001; De Clercq & Dimov, 2004). The end goal of any syndication, apart from reducing and sharing risks, is to raise the mean expected return on the investment (Lockett & Wright, 2001). Syndicating has been shown to achieve this result, as these syndicated investments tend to produce higher IRRs for the venture capital investor (Cumming & Walz, 2004). Complementing the improved return profile of syndicated venture capital investments is the notion that often the lead investors in those transactions will have a lower required return on capital in the early-stages of the venture than would otherwise be the case if making the investment alone. This tendency has been attributed to the ability of a syndicate to provide superior access to information and better *control* of the venture (Manigart et al., 2002).

Venture capitalists syndicate their investments either to manage the portfolio of investments at the fund level, or the individual investments themselves (Manigart et al., 2006). When used as a tool to manage a portfolio, syndication is undertaken to reduce unsystematic risk through diversification (Bygrave, 1987; De Clercq & Dimov, 2004), provide window dressing⁷ for the investment fund (Lerner, 1994), improve reciprocal deal flow (Sorenson & Stuart, 2001), and/or share the due diligence burden and costs across a portfolio (Lockett & Wright, 2001).

On the investment side, where more than one investor is involved, the selection of investments is often ameliorated due to improved screening, due diligence and decision making (Brander, Amit, & Antweiler, 2002; Lerner, 1994). Investee firms will often receive a

⁷ Lerner describes an example of window dressing in the pension fund industry as managers adjusting their portfolios at the end of quarter by buying firms whose shares have appreciated and selling “mistakes”. This practice allows the portfolio of companies to have an appearance of better performance than has actually been achieved.

higher level of expertise and experience as compared to those firms with only one investor (Hellmann & Puri, 2002; Sapienza, 1992). Syndicating can also mitigate governance problems (Lerner, 1994), and provide improved exit potential due to the markets perceived value of reputable investment firms first making the decision to invest through positive signalling (Stuart et al., 1999; Hursti & Maula, 2007).

This researcher could only find one piece of research on syndication in a South African context. Bent et al. (2004) published in the South African Journal of Business Management a piece titled, *The syndication of private equity investments in South Africa*. The research represented a survey of South Africa Private Equity⁸ firms to determine whether they were motivated to syndicate by sharing financial risk (finance-based rationale), accessing specific resources of other firms (resource-based rationale), and/or increasing deal flow (deal flow rationale). The survey largely followed the example of Lockett and Wright (2001) in the UK and Manigart et al. (2002) for Europe. Of the 42 firms in the sample, 70% (or 30) responded, and 60% of the responding firms had previously syndicated.

The core finding was that the most important reason for syndicating a private equity investment in South Africa in the early-2000s was the large size of the investment in proportion to the available funds. The two least important reasons were that the investment was in a sector in which the firm does not usually invest, and that the opportunity was outside their usual investment stage. The top two rationales were therefore finance-based. Within the resource-based rationale, the most important reason given from the industry professionals at that time was the need to access specific skills. Future reciprocal deal flow was cited as important, but ranked as the third most important in this survey. Black Economic Empowerment (BEE)⁹, though not included in the questionnaire directly, was mentioned as a rationale for syndicating in South Africa.

⁸ Note that this study focused on private equity, and not specifically venture capital as in the study at hand. The average size of the syndicated investments in the research were ZAR 237.9mn.

⁹ In South Africa, the BEE legislation aims at increasing participation in the formal economy by inducing companies to have more shareholders and employees of what is termed previously disadvantaged backgrounds (i.e., those largely excluded from protection and benefits under the Apartheid regime). BEE has now been replaced by Broad Based Black Economic Empowerment (BBBEE) which has the same objectives as BEE. BEE and BBBEE are South Africa's leading approaches to indigenisation.

The preponderance of the research indicates that venture capitalists much prefer to invest close to their proximity (Gupta & Sapienza, 1992; Sorenson & Stuart, 2001; Lerner, 1995; Norton & Tenenbaum, 1993). In spite of that tendency, for a number of reasons US and European venture investors began to intensify their investments into foreign markets in the late-1990s (Aizenman & Kendall, 2008; Alhorr et al., 2008; Meuleman & Wright, 2011). A stream of research has emerged which looks at syndication of venture capital investments through an international lens, and that research is described below.

3.3 Drivers of cross-border investments and syndication

It is often very challenging for ventures to attract foreign venture capital (Makela & Maula, 2008). In many markets, having the ability to attract foreign capital from more developed and deeper capital markets (e.g., US and Europe) can make the difference in whether funding ever occurs due to the anaemic nature of many domestic capital markets (Wright et al., 2005).

There are at least 2 reasons why venture capitalists invest abroad. First, by crossing borders they can exploit differences in risk-adjusted returns between the home and portfolio countries (Schertler & Tykvova, 2012). Returns vary across markets for a variety of reasons including less competition, higher growth prospects, and other macro and micro differences between the domestic and foreign investment ecosystems. One of the pitfalls of investing across borders is higher transaction costs, which tend to be markedly higher than for domestic investments (Wright et al., 2005; Cumming & Johan, 2007). Obviously, the variance in return must be greater than transactions costs for the investment to be justified.

Second, they co-invest abroad for the other aforementioned reasons inherent to investment syndication in general. These include reducing systemic risk through diversification, monitoring costs, due diligence and initial screening costs. These also include improving chances of an IPO exit, deal flow, and expertise for the investee company by bringing investors to the investment with valuable skills and networks.

Venture capital flows are greater where a suitable domestic co-investment partner is present. This is the case not only due to the local investor's contacts and knowledge of the market, but also because they take care of certain responsibilities that are easier (and more cost efficient) to manage from a close proximity such as monitoring and day-to-day management of the investment (Makela & Maula, 2008). It should be noted that the positive effects of a domestic co-investor are diminished where the venture has a strong entrepreneurial team, and this occurs because less monitoring and management support is required by the investors in those ventures (Makela & Maula, 2008; Sapienza, 1992). This phenomenon extends to situations where the home market, and thus the local investor's knowledge and local networks, is not as important in terms of sales or as a launching pad of international operations (Makela & Maula, 2008).

Also driving cross-border syndication are contractual and regulatory uniqueness of a country and degrees of legal protections offered by a country. Research on the impact of regulatory and contractual uniqueness indicates that these differences have a material effect on a transaction and decision to form a cross-border syndication (Black & Gilson, 1998; Bruton et al., 2005; Jeng & Wells, 2000). This effect is especially prevalent where one investor operates in a common law system (e.g., UK and USA), and the other under a civil law code (Cumming & Flemming, 2004).¹⁰ Countries often differ as to the degrees and manners of legal protections offered to investors (La Porta et al., 1999; La Porta et al., 1998). Local investors grasp these nuances, and will often have developed informal mechanisms to deal with gaps in the protections offered by the State and other local institutions (Meuleman & Wright, 2008).

3.4 Benefits of cross-border investing through syndication

The body of research on the benefits of international syndication indicates that they can offer the following benefits: reduced costs, superior performance, better decision making, higher levels of ongoing commitment, and transfer of high social status from and to the investors and ventures.

¹⁰ South Africa, through founded as a Roman-Dutch legal system, has largely adopted the English Common Law system of jurisprudence.

3.4.1 Reduce Costs:

Having an investor in close spatial proximity to a venture can be especially important in the early years of a venture when more assistance and monitoring are required (Fritsch & Schilder, 2008). The further the distance¹¹, the more difficult and expensive these monitoring and support functions become (Dai et al., 2012). Often, when firms make cross-border venture investments they devote less energy and resources to the venture due in part to higher transaction costs (Sapienze et al., 1996; Frisch & Schilder, 2008). The higher transaction and ongoing costs become even more difficult to justify in instances where the venture is not as successful as expected, and perhaps more important than withholding future funding, the research shows that time commitments to these far away ventures can wane more than those nearby (Makela & Maula, 2006). By reducing costs and having at least one investor near the venture, many of these disadvantages of distance are mitigated.

A foreign investor can also reduce costs by assisting in internationalizing the venture and thus make trading in foreign markets less costly in at least a few ways. First, the presence of a foreign investor generally makes learning about and expanding into that market less costly (Makela & Maula, 2005). Second, the foreign investor can more easily connect the venture to networks and relevant foreign suppliers, customers and financiers in the foreign investor's country (Makela & Maula, 2005). That connection to foreign markets has been shown to increase the likelihood of a portfolio company expanding where an international investor is present (Yli-Renko et al., 2002; McDougall et al., 1994; Makela & Maula, 2005). Third, a foreign investor can provide benefits in the form of an endorsement (Stuart et al., 1999; Makela & Maula, 2005) in the local market where the foreign investor has a high-status.

3.4.2 Better performance:

Under the right conditions, venture capital investments which contain both domestic and international investors perform better (Chemmanur et al., 2010). In a study on internationally syndicated venture capital investments in Canada, Brander et al. (2002)

¹¹ In this context, distance also refers to cultural, language, legal and other differences besides just geographic distance.

found that these investments outperform those with only one country represented in the venture syndicate.

Hochberg et al. (2007) suggests that the increase in performance can be at least partially explained by the strong established networks of firms who tend to syndicate. That research found that better-networked venture capitalists are more likely to syndicate and to be attractive co-investment partners. The strong networks, they argued, led to more access by the portfolio companies to future funding, customers, strategic alliances and service providers (e.g., headhunters and investment bankers). To derive these conclusions the researchers looked at the rates and patterns of syndication of 3,469 US venture capital funds that participated in 47,705 investment rounds involving 16,315 portfolio companies¹².

Other research suggests that knowledge sharing is another contributor to success. De Clercq & Dimov (2008) found that improved performance is more pronounced where one of the investors has a specific knowledge which closes an *exposed gap* in the other investor's knowledge and/or expertise. They looked at 200 US venture capital firms, through a longitudinal study, and determined that investing in industries in which a firm has more knowledge and investing with a more familiar external partner enhances investment performance.

Seppa (2003) found a link between investor prominence (international or local) and valuations of venture backed companies. Due to the sophistication of a high-status co-investor, valuations are often lower at the front end, which was attributed to the higher bargaining power that high-status investors possess. In later rounds, the converse is true vis-à-vis valuations. Valuations in later rounds increase due to that same bargaining power, experience, and the ability to add value to the enterprise prior to seeking future funding or an exit. These phenomena are value enhancing and increase investment performance.

¹² The data came from Thomson Financial's Venture Economics database.

3.4.3 Better Decisions (less risk) Due to Sharing Knowledge:

Domestic investors will generally have a more fine-grained understanding of the local legal institutions, where to find certain resources, and offer more nuanced and potent business and expansion advice (Devigne et al., 2011). They also may have valuable knowledge about the operation of the local market, including deal flow, along with a profound network of contacts and familiarity with the different local requirements (Meuleman & Wright, 2008). To effectively augment and adjust its knowledge about a foreign market, a foreign venture capitalist will often co-invest with domestic investors to gain knowledge about the local institutional environment (Bruton et al., 2005). Due to the smaller budgets and fund sizes of venture capital investors (relative to private equity funds and larger multinational corporations), and necessity to invest in and manage more companies, co-investing is often the preferred knowledge generating mechanism for early-stage investment firms (Buckley et al., 1992; Meuleman & Wright, 2008).

International investors from the developed venture capital markets often have a specialized and potent set of knowledge points and networks which can be extremely valuable to the right venture. This phenomenon is explained by a tendency of developed world investors to specialise in certain niches in order to remain competitive (Busenitz et al., 2004; Hellman & Puri, 2002). There is value in combining local knowledge with the specialized knowledge and networks of international investors, where those niche areas of expertise are relevant to the venture. Supporting this research are the well-established assumptions in the field of international business which indicate that knowledge gleaned from operating in a home country is often not directly relevant or useful when expanding abroad (Dunning, 1993; Johanson & Vahlne, 1977; Kogut & Zander, 1993; Vernon, 1979). That knowledge must be purchased, learned organically through trial-and-error, or ascertained through including suitable local investors in the consortium.

Knowledge sharing between international investors and the portfolio company can also impact the internationalization of the venture. Where a foreign investor is participating in the investment and openly shares information pertaining to internationalization and international markets, internationalization of the venture occurs which carries various useful and diverse benefits (Fernhaber et al., 2009; Lutz & George, 2010).

Internationalization is often driven towards the home market of the international investor with sometimes detrimental effects (Makela & Maula, 2005).

3.4.4 Higher Exit Potential

The ability to successfully exit an investment is a key component of the *Venture Capital Cycle* (Gompers & Lerner, 1999). Jones (2009) does a nice job of describing why this is the case by outlining prior literature which show the importance of viable exit availability to fostering private investment. That prior literature consumes the remainder of this paragraph and begins with Jeng & Wells (2000) who in a study of 21 countries found that the availability of IPO exits is a significant determinant of later stage funding. Da Rin et al. (2006) looked at 14 European countries and found that opening a stock market targeting entrepreneurial ventures has a positive net effect on that domestic venture capital ecosystem. Farag et al. (2004) suggests that lack of viable exits other than trade sales has a negative impact on venture capital in a country, and based their findings on a study of Central and Eastern European transactions. Lastly, Banerjee (2008) showed that a key factor in venture capital development in India was a surging stock market with attractive valuations for investors.

Other research in this space of venture exits and their relation to the international nature of a syndicate offers interesting findings. First, when a foreign investor is involved in a transaction the likelihood of a successful IPO exit increases (Hursti & Maula, 2007; Jaaskelainen & Maula, 2005). Second, the probability of a successful exit when investing abroad increases significantly when distant venture capital firms syndicate with venture capital firms located nearby to the venture (Cumming & Dai, 2010; Moser, 2010). Lastly, companies with venture investors tend to experience lower costs when it is time to go public for a multitude of reasons including prior experience of the venture capitalists, and the fact that venture funded companies often have tighter books, stronger networks and fewer 'skeletons' (Megginson & Weiss, 1991).

3.4.5 Higher levels of on-going commitment to venture

An issue when investing abroad is commitment to ventures which don't live up to expectations immediately. Local co-investment partners tend to induce higher levels of on-going support and commitment to the investment by the foreign co-investor (Makela & Maula, 2006). This effect diminishes in foreign venture capital investors with less distance to the country of the investment, possessing other investments in the market, having more long-term reciprocal relationships with co-investors in the country of the investment, and where higher financial stakes (i.e., larger deals) are present (Makela & Maula, 2006). The research by Makela & Maula applying *commitment theory* to internationally syndicated venture capital transactions is described more fully in chapter 6.2.6.3 of this research.

3.4.6 Positive social status of having a foreign investor

Positive social status of a reputable foreign investor transfers particularly well to a domestic investor and venture (Guler & Guillen, 2009). It's been shown that high-status investors provide a strong signal to the market which attracts other investors, increases the venture's chances of success, and entrepreneurs will often accept a discount in valuation to receive these (and other) benefits of a high-status investor (Gompers & Lerner, 2001; Lerner, 1994; Stuart et al., 1999; Piskorski, 2004; Hockberg et al., 2007; Hsu, 2004; De Clercq & Dimov, 2004). This effect seems to also go the other way in that participation of high-status venture capital firms in the country of the venture may play a positive role in legitimizing the venture in the eyes of the foreign investor (Hursti & Maula, 2007; Makela & Maula, 2005; Stuart et al., 1999).

3.5 Risks/Constraints of cross-border investment and syndication

There is scant mention of risks and constraints of cross-border investing and syndicating in the existing body of literature.¹³ However, there is literature which touches indirectly or in passing on international syndication, both domestically and across borders. There is also

¹³ This is probably a logical development, given the relative youth and shallowness of the prior research in the field. More research is needed in this area.

relevant literature in various areas of international business which look at risks and downsides to be mitigated with international partnerships. Some of those are described below.

The benefits of interfirm cooperation and co-investing with domestic and international investors can be offset by the contractual risks associated with forming such partnerships (Caves, 1996). These risks can include, but are not limited to, increased transaction costs associated with more negotiations and necessity to accommodate all parties, a higher likelihood of disagreements occurring throughout the transaction, and difficulty in concluding the transaction due to more deal complexity.

Amit et al. (1998) is one piece of literature this researcher found with direct insights into risk and constraints in a venture capital context. The researchers describe how transaction costs are amplified in venture capital or other early-stage investments due to those investments being more opaque and uncertain, with information asymmetries between the entrepreneur and investor more pronounced. The heightened level of due diligence of these investments requires substantial pre-investment screening, on-going monitoring after the investment is made and continuous control of the venture and relationships through various mechanisms.

Meuleman & Wright (2008) suggest that making cross-border venture capital investments further add to these costs. Physical distance is a factor in their analysis, but so too are other distances such as cultural, language, rule of law and business custom differences. As firms learn about the foreign market, the incentive to co-invest could diminish due to the desire to avoid and remove such interfirm risks.

The body of literature on the *liabilities of foreignness* is also edifying, and describes the risks and costs associated with operating in a foreign market. When firms and investors expand internationally, those costs that result from unfamiliarity with the new market, and from political, cultural and economic difference between the foreign and domestic markets cause this phenomenon of *liability of foreignness* (Zaheer, 1995; Dia et al., 2010). These effects are amplified where the venture is early in its development and without the resources or

skills to cope in the new environment (Clarysse et al., 2007; Zahara et al., 2007). Although one of the aforementioned benefits of having a local investor in the syndicate is knowledge sharing, the risk remains and is hardly ever perfectly mitigated, even with an ideal local investor in the syndicate.

In a 2009 study by Du on the heterogeneity of syndicate partners in venture capital investments, it was found that heterogeneous syndicates may incur higher transactions costs ex post. Communication and coordination costs can be higher, leading to more conflicts, slower decision making and delayed execution. Different knowledge of one market can increase the information asymmetry among venture capitalists, leading to less effort from the experienced investors. Lastly, the study found that due to these higher transaction costs, venture capitalists prefer homogeneous syndicates, and that the heterogeneous syndicates may underperform those funded by homogeneous venture investors. It should be noted the above study by Du defined heterogeneity of venture investors largely by levels of experience and prior performance.¹⁴ The study also dealt solely with domestic syndication.

Many of the key constraints of the types of relationships as studied in the research at hand revolve around agency issues. Agency issues are those concerning the difficulty in motivating one party (the agent) to act in the best interest of another (the principal) rather than his own interest. In an international syndicate backed venture capital relationship, there are agency issues both between the entrepreneurs and the investors, and between the investors. Those which exist between the entrepreneurs and investors are fairly obvious, and one of the advantages of having a local partner in the consortium is the ability to mitigate those agency issues through efficient monitoring and interacting with the management team. The agency issues between the investors, however is more difficult to address and understand. Many of the larger transaction costs associated with international transactions are attributable either directly or indirectly to the agency issues among investors.

¹⁴ Du also controlled for venture capital connectedness, geographic distance among venture capitalists, geographic distance between portfolio companies and prior syndication among venture capitalists and the results held.

One agency issue in particular which has been studied in a cross-border syndication context deals with *cream skimming*,¹⁵ or the propensity of local investors to invest in the best ventures and to then include international investors in the deals which remain. The incentive to behave in this fashion is perfectly natural, and based on a desire to not dilute future returns (Guler & McGahan, 2006). Apart from withholding the best deals from the international investor, there are other inherent agency problems which slow international syndication such as when an informed investor does not disclose all known and material information (Admati & Pfleiderer, 1994; Filatotchev, Wright & Arberk, 2006).

3.6 Role of the Local Partner

There is one piece of known literature which specifically addresses the role of the local partner in an international syndicated venture capital backed venture transaction. That piece is by Makela and Maula (2008) and titled, *Attracting Cross-Border Venture Capital: The Role of Local Investment Partners in International Syndicate Arrangements*. Owing to the lack of prior research and available data in the field, they chose an inductive approach building on case study analysis from which to draw the following conclusions.

They determined four attributes which mattered in these transactions and relationships. Those are the existence of a high quality local investor, participation in the management of the local investor in the venture's management, local investor's knowledge and social capital in the local market, and degree of international social capital with other foreign investors possessed by the local investor.

First, the existence of a high quality local investor matters as they are often first to invest, with foreign investors joining in later rounds. The status of the local investor signals to the international community that the venture has been vetted, and is viable. These findings were supported by prior research (Stuart et al., 1999).

Second, participation of the local investor in the venture is key as it can more effectively manage cultural, language, regulatory and other operational decisions than an investor

¹⁵ Cream Skimming is addressed later in this research in Chapter 6.2.6.1.

operating from a different country. Interestingly, the researchers found the better the entrepreneurial experiences of the management team, the less profound the benefits of having a local investor. Intuitively, this makes sense as well run ventures require less monitoring, a finding that is also supported by prior research (Sapienze, 1992; Kuemmerle, 2002).

Third, the local investor's knowledge and local social capital are valuable as these networks and knowledge are readily transferable to the venture, making a successful outcome for the venture more likely. As with providing monitoring functions, where the management team has existing local social capital, the value of the local investor diminishes, and that statement is supported by the same research (Sapienze, 1992; Kuemmerle, 2002).

Lastly, strong international networks of the local investor increases the likelihood of an international syndicate forming. Even were ventures are not *cross-border investment ready*, the investors in the sample with strong international networks were often able to source qualified foreign investors. Investment readiness, and receiving investment, they found were not always perfectly correlated. The findings are supported by international literature on the effects of international social capital on resource acquisition (Arenius & Autio, 2002; Autio, 2005).

Jaaskelainen et al. (2006) also supports the proposition that the local investor is best positioned to serve as the lead investor. The management of a syndicated investment, they suggest, is typically the responsibility of the lead investor who manages both the venture and the syndicate, and often sits on the board and is more hands on with the monitoring. A non-lead investor will usually spend 1/10th of the time on management of a syndicated venture as compared to the lead investor (Gorman & Sahlman, 1989).

4 Methodology and Sample

4.1 Research Approach and Strategy

A review of the literature, as has been demonstrated, shows that there are several benefits of international syndication to both the venture and the investors. It's likely that internationally syndicated venture transactions, if properly structured, would benefit South African ventures and investors. The purpose of this research is to assess why these transactions aren't more common, and to identify whether the local venture capital investors are ready and willing to syndicate internationally, and the constraints in South Africa which may be hindering these transactions.

Recognizing that the body of international literature is in its relative infancy, interviews¹⁶ were chosen as the means of gathering data. This is appropriate for at least two reasons. First, interviews allow for a more open and broad manner of gaining understanding. Since little is known about the international syndicating patterns in South Africa (and for that matter internationally), giving the interviewees freedom to roam and proffer insights was preferred to the more limiting and direct responses which often result from questionnaires. Second, given the current nascent nature of the venture capital ecosystem in South Africa, there aren't many active and/or credible investors from which to gather insights. Interviews allow for a more exhaustive exploration of the subject, and in a way more likely to uncover novel and important dynamics of these transactions in South Africa. With an understanding of the pros and cons of each, the more difficult and time consuming interview methodology was selected for this research.

This research, then, is of a qualitative nature given that the investigation revolves around insights and opinions rather than specific data. Understanding the nature, limitations and strengths of this type of research is important. Peshkin (1993) cited in Leedy & Omrod (2005) describes the benefits or purposes of qualitative research as being:

¹⁶ More on the interview instrument and structure are include in subsection 4.3 of this chapter.

- *Description* – revealing and describing how things are in particular situations, settings and contexts,
- *Interpretation* – enabling the research to gain new insights into particular phenomenon and/or discover the problems that exist within a particular phenomenon,
- *Verification* – the researcher is able to test existing theories and assumptions within a real-world context, and
- *Evaluation* – the researcher can investigate the effectiveness or otherwise of particular practices and policies in respect of the particular context.

As described by *Bryman & Bell (2007)* cited in Morgan (2009), the key limitations of qualitative research are:

- The problem of subjectivity with respect to the researcher's interpretation and selection of data. This is partially mitigated by this researcher having a firm understanding of the existing body of research on the topic prior to the interviews, and the fact that the questions are largely open-ended. Interpretations and analysis will be based on that prior research.
- Qualitative research is difficult to replicate in that the research design and implementation coupled with the involvement of the researcher means that the precise methodology is unlikely to be exactly replicated. This limitation is partially mitigated by the fact that each interview is conducted with the same interview structure. Additionally, the nature of the data sought in this case is not the type which necessary needs to be replicatable to be viable and relevant.
- Problems of generalization – can findings be generalized to other settings? This limitation is partially mitigated by the narrow scope of this study, which does not include generalizing conclusions to other markets and industries.
- Transparency is often a concern in qualitative research in that it is often difficult to fully understand what the researcher did in arriving at his or her conclusions. It is hoped that this limitation is mitigated by offering a detailed description of the way in which the interviews were prepared, administered and data gleaned analysed.

4.2 Sampling

The sample group was defined by firstly looking at the South African Venture Capital and Private Equity Association (SAVCA) members list as reported in its 2013 industry review. The full membership list for SAVCA contained contact details for 121 Firms. After excluding firms which weren't actively engaged in private equity investments, under which venture capital is a sub-asset class, the number dropped to 85. Firms would self-report as not being actively engaged in investing for a number of reasons including (but not limited to) lack of funds, already having a *full* portfolio of investments, or a strategic decision to abstain from investing in South Africa for a period. Whatever the reason, they were excluded.

As this research is focused on venture capital investments, eliminated further were those firms which self-reported an unwillingness to participate in early-stage investments, reducing the sample size to 30. Next, eliminated by category were those firms which operate fully or in substantial fashion within the government sector. Government investors were eliminated to make cross-comparison more effective due to the fact that the international body of literature which has interviewed or surveyed through questionnaires practitioners do not contain a significant number of government actors.¹⁷ Further eliminated were those SAVCA members that indicated a current position of not making investments in South Africa, leaving 21 firms.

The population of 21 firms was then reduced to 7 when firms which were either known to be no longer investing and/or winding down operations, not having a physical presence in South Africa¹⁸, or firms with mandates to make primarily socially ameliorative or impact investments. Those decisions were made based on a review of newspaper and magazine articles, discussions with individuals who operate in the space and the respective company websites. This final population from which the sample was drawn represented 5.78% of the database of 121 firms. The number of investment executives at the 7 firms, according to the SAVCA database, is 23.

¹⁷ Most of that research comes from Finland, the US, Germany and Israel. These countries have vibrant international investment climates and track records with almost entirely private sector participants.

¹⁸ Conceivably foreign firms become members to have a connection to South Africa which could have several benefits such as deal flow and improved access to service providers.

As a reasonability check it's edifying to look at Van Deventer (2009) who administered surveys to South African venture capitalists and also used the SAVCA database as a starting point. In that sample, 16 firms were identified as venture capital firms to be surveyed. Assuming the sample of 16 is reduced in a corresponding fashion to the decrease in venture capital transactions from 2008 to 2012¹⁹, that new *phantom* sample would be 8 firms which corresponds closely to this sample of 7.

There are at least 2 limitations to this sample. First, not all entities which make venture capital investments into South Africa companies are SAVCA members. Many are angel investors, or firms which for their own reasons choose to not join SAVCA. Due in large part to SAVCA's strong reputation and position as the leading industry representative, there are a very small number of firms with capital to invest which aren't SAVCA members. As such, the loss of those firms is not believed to have a material impact on this research. Second, the data is self-reported so funds could inflate/deflate numbers to gain a perceived advantage, or downplay a weakness, in the eyes of other SAVCA members or public. This second limitation is mitigated by the fact that SAVCA sends descriptive surveys each year to its members, leaving little ambiguity, and the small scale of the South African venture capital industry decreases information asymmetry, and makes embellishing results more likely to backfire.

4.3 Data Collection Methods and Research Instrument

4.3.1 Data Collection

The primary source of original data in this research was derived from interviews conducted with 7 venture capitalists and early-stage investors in South Africa. The interview questions were primarily open-ended, however a limited number of questions were close-ended. The interviews were conducted either in the interviewee firm's boardroom (4), or telephonically (2), and in one case in a nearby restaurant near to a conference venue where the

¹⁹ According to the SAVCA Venture Solutions survey in 2012 the number of transactions from 2008 to 2012 was nearly halved.

interviewee was speaking. A copy of the interview structure and notes used by this researcher in each interview is included in the appendix.

All participants were initially sent an email describing briefly the research, with an invitation to participate. Of the 7 responses sent (7 corresponds to the number of firms in the sample) 7 individuals agreed to an interview, from 5 firms. The remaining 2 firms never responded after repeated follow-up emails and phone calls. One firm offered 3 interviews from various professionals at that firm. Thus, the response rate to interview requests was 71.4% at the firm level. At the 5 firms interviewed, there are 17 investment professionals employed, according to the SAVCA database. The 17 professionals represent 73.9% of the total sample of 23 professionals. This response rate is commensurate with Van Deventer (2009) who had a response rate of 75% after 12 of 16 South African venture capital firms respond to a request to complete an online survey.

Each interview was handled similarly, and the length of each interview ranged from 45 minutes to 1 hour and 15 minutes. Recording the interviews was decided against to encourage a free flow of information and to increase the number of the population agreeing to be interviewed. Each interviewee was told that the firm and individual's names would not be mentioned in the report, and that all information and data would be presented in aggregate, and in a way to make pinpointing the respondent and his/her responses very difficult and unlikely. This researcher felt these steps to be necessary given the very secretive nature of the industry in general, and more especially in South Africa. As evidence of the extreme care to which many South African venture investors take to conceal their deal and transaction information, one should notice the number of deals and investments which are never disclosed to the public, and when they are the amount of the investment and the general terms of the deal are more often than not excluded from the discussion. Contrast this with the situation in the US and Europe, for example, where that type of deal insight is almost considered public information and expected to be divulged.

The data collected were responses, handwritten by the interviewer, under the specific question being asked at that point on the interview notes taken to each interview. In instances where an interviewee would offer insights into an already discussed question, the

interviewer would log those notes under the preceding question's note space. Later, these responses were categorized (chapter 5) and analysed (chapter 6).

4.3.2 Research Instruments – Interview Question Preparation

To determine if South African venture investors are ready and willing to syndicate internationally, a three pronged approach was incorporated into the structure of the interviews. First, each interviewee was asked directly whether or not their firm had internationally syndicated, and if they had approached or been approached for the same. The rationale for this set of threshold questions was to determine if the option to syndicate internationally had come up in prior dealings, and also whether it was a strategy which had been contemplated. Other relevant demographic information of the interviewees were also collected at this stage.

Second, the perceptions of benefits of internationally syndicating venture capital investments to both the South African investor and the international investor were determined. By ascertaining the perceptions of benefits in the minds of South African venture investors to both the local and international investor through interviews, it would then be possible to compare those results to these prior findings and academic gleanings. The importance of that comparison is at least two fold. First, if the South African venture investors perceive no or limited benefits to syndicating internationally, then that is evidence of at least part of the cause of the condition this research seeks to understand. Second, assuming the respondents do perceive benefits the benefits they highlight, omit and include in their responses also offer valuable insights both in their own right, and when compared to those described in the international body of literature. Motivations for syndication were also ascertained to further elucidate the local investors' attitudes towards co-investing with international investors into South African ventures.

The third category of questions related to constraints to syndicating internationally. As mentioned, this area is not often researched so these responses have the potential to significantly shape the international understanding of the field of international syndication

of venture investments. Perhaps more importantly, the responses would be the first²⁰ fodder for academic analysis of what the constraints to these transactions may be in South Africa.

In terms of the verbiage and structure of the actual questions, they were generally construed and left open-ended by design. Not only would open-ended questions tease out those responses at the forefront of the interviewees' understanding, they would also allow for a more relevant and targeted series of follow-on questions to learn more. The propensity of the questions to lead the interviewee to certain responses was also reduced through this strategy.

As a final point, the interview questions and structure were reviewed by this researcher's supervisor, and cleared by the Commerce Faculty Ethics Committee at the University of Cape Town. All feedback from these and other sources were contemplated and incorporated into the final interview structure and process.

5 Results

The handwritten notes from each interview were condensed to one comprehensive document showing the questions asked, and the notes taken. Repeated responses were lumped together and were thus only written once. Certain responses were flagged as more important than others. The decision to flag a response was based on a factor analysis of the following elements: repeated mentioning throughout the interviews, a perception by the interviewer gleaned from tone and other non-verbal cues that the response was more important, and more time taken during the interviews to address certain topics and ideas. In the listings below, those flagged responses are underlined.

Interpreting some responses as more important than others has the positive impact of further shaping the data and analysis to show which benefits, constraints and motivations

²⁰ There is research on deficiencies of the South African ecosystem, which have been previously described. While that research was instructive in the discussion of the results, it sought to understand the venture capital industry in South Africa in general, while this research looks more narrowly at the topic of international syndication in a South African context.

were at the forefront on the interviewees minds. However, this researcher is well aware that a response being mentioned more often, for example, does not itself prove a causation or higher correlation to what is being measured than do the other responses. Further, more time devoted to discussing a topic may only prove that the particular topic lends itself better to explanation relative to other topics, which may or may not have more relevance to this research.

5.1 Demographics

In the course of and leading up to the interviews, demographic data was collected from and on the interviewees. This data is presented below in order to further understand the participating sample, and place the findings and analysis in subsequent chapters in context.

The respondents came from 5 firms. Collectively, they have invested and have cash reserves worth approximately USD 83mn. This figure is an estimate and based on information from industry professionals in South Africa, news articles and SAVCA data. As has been previously discussed, fund values are often left undisclosed in South Africa, along with details surrounding investments and investment sizes. Managing those investments and assets for the five respective firms are approximately 17 investment professionals. The combined number of early-stage investments of the 5 interviewed firms is 26. The investments range from very small seed investments, to relatively large series A²¹ and follow-on rounds of more that USD 3mn. Here is a table showing these data points visually (rand/dollar exchange rate of 10/1 assumed):

Table 5: Financial character of research sample

	USD	ZAR
Collective AUM	83mn	830mn
# of firms	5	
# of investment professionals	17	
Collective Investments	26	
Avg. assets per professional	4.8mn	48mn

²¹ Series A investment is a company's first significant funding round and does not include seed or other previous smaller fundraising rounds.

All of the respondents have been approached by foreign investors and/or firms to be co-investment partners in a South African venture. All but one has returned the favour by inviting an international investor to serve as a co-investor in a South African venture. The respondents all expressed a desire to syndicate with international investors, however none had a strategy to do so, nor a track record of successfully partnering with foreign investors.

All but one of the firms interviewed are independent financial firms, with one being a captive to a larger institution. The average age of the firms in the sample is 4.4 years. All of the firms were funded by private shareholders, with one firm also having Developmental Finance Institutions (DFI)²² shareholders.

5.2 Benefits

The listings below present the responses received during the interviews. In the discussion section in Chapter 6, these responses are each placed into categories, and those categories of responses analysed.

Question 1 - What are in your opinion the benefits to you of having an international co-investor in a South African based venture?

- Gaining access to new markets. If the foreign investor is in one of the possible expansion markets, that local market knowledge of the foreign investor can assist the South African venture expand more quickly.
- Access to capital will be improved which is important in South Africa due to the seeming lack of available risk capital.
- The ability to attract purchasers (and IPOs) later in the investment cycle will likely be improved, especially where the international investor is in a country with a deep capital market.
- By having a high-status international investor the venture is validated and serves as a sort of stamp of approval. This stamp of approval carries with it many benefits.

²² Examples include the Overseas Private Investment Corporation (OPIC), Industrial Development Corporation (IDC), Commonwealth Development Corporation (CDC), International Finance Corporation (IFC), Development Bank of Southern Africa (DBSA), among others.

- South African venture capitalists are largely generalists without specialities. Foreign investors tend to specialize so bringing in the appropriate foreign investor could mean having an investor with years of experience in that narrow band/field which the South African venture operates.
- The foreign capital markets are deeper and having an investor from one of those markets in the consortium should lead to the ability to do bigger deals and makes follow-on investments easier/possible. In other words, access to capital is improved.
- Track record of doing deals from foreign investors. The local industry is relatively young and inexperienced. Possessing a foreign investor with a greater track record of concluding investments brings a lot of knowledge to the table in terms of best practices and new developments in the industry.
- The foreign investor, attributable largely to a deeper set of past experiences, should be able to more quickly and effectively assist in the due diligence required to size up the investment. This could equate to a lower total transaction cost and improved upfront screening.
- South African venture capitalists tend to scrape up money and fund with not as much thought to future funding rounds as international investors. Not only do international investors have access to more capital, they have a mind-set which contemplates a strategy towards future funding rounds.

Question 2 - What are in your opinion the benefits for the international firm of having a local co-investor (like you) when investing into a South African based venture?

- The investment is de-risked in many ways as the local investor has local knowledge, and can remotely manage the deal. These benefits include localised due diligence processes, validation (if SA firm is high-status), knowledge of local nuances/regulatory hurdles, local networks and support services which are valuable pre- and post-investment.
- Cost reduction is a benefit due to lower ongoing monitoring and due diligence costs as compared to those which an international investor would accrue if investing alone. Deals are smaller in South Africa so foreign investors could very well invest more in air travel and attorneys (to name two) than the actual investment, in some cases.

- Often where a high-status local investor is involved the venture receives instant credibility.
- There is a tendency only to invest in early-stage deals where you know the market, so a trusted local South African co-investor is important to induce these investments and to make the foreign investor feel like it has the requisite knowledge to make an investment.
- It's believed that South African ventures and entrepreneurs require more *hand holding* than those in the developed world which makes having a local investor to carry out those functions even more valuable.

5.3 Constraints

The listings below present the responses received during the interviews. In the discussion section in Chapter 6, these responses are each placed into categories, and those categories of responses analysed.

Question 3 - What do you perceive to be the constraints to international investors co-investing with South African investors in South African ventures?

- Reserve bank exchange controls are a constraint due to the regulatory headaches and high levies. These controls make it more difficult for the South African venture to transact outside of South Africa, to raise foreign debt funding (which is commonly used especially in Europe), and to exit to non-South African buyers.
- IP protections are also a constraining factor in similar ways to exchange controls.
- Political risk is a problem and although the perception among foreign investors is often greater than the reality, it deters investment.
- The early stage investment deals in South Africa are generally smaller than what is seen in more developed markets which can make it difficult to entice foreign investors to invest or to even take a close look at the opportunity.
- There may be more attractive places than South Africa to place capital at the moment. The opportunity costs of those foreign investors of investing in South Africa could be too high to justify an investment.

- Entrepreneurs are perceived to not be as strong as in the developed markets and will usually require more guidance and handholding than is usually required.
- Fees to navigate regulatory hurdles can be great and can deter investment.
- It is very difficult to tell the investment story for the South African early-stage investment asset class due to there not being many case studies or much data on previous deals or statistics on the local industry.
- There have been very few notable exits in South Africa and the ability to generate returns consistently to domestic or international investors has not yet been adequately demonstrated.
- There are limited existing relationships with investors in foreign markets which makes presenting opportunities and knowing who to approach challenging.
- There is probably a dearth of bankable/investible deals in South Africa which are investment ready and that would be attractive to sophisticated foreign investors.

Question 4 - What would be your reservations to having international co-investors?

- Regulatory hoops (i.e., anticorruption and tax laws/requirements) which the foreign investor must jump through. This reservation also applies also to DFIs who have mandates that include more than just return-based objectives.
- Due diligence of the other investor(s) can be time and resource consuming.
- Shareholder agreements can become 'painful' with multiple parties, especially if the mandates aren't directly compatible.
- If the investor is just a financial investor, then the South African venture capitalist would be hesitant to allow it into the consortium. There is a preference for a strategic investor who, apart from capital, also brings a specific skill/network to the deal. Stated another way, there is a reluctance to give foreign investors the *good deals* to those investors who would not be providing real value to the transaction and venture.
- Terms and structuring may be different in the foreign market and disagreements could arise between the foreign investor and the South African around the proposed structure.
- May differ with international investor in terms of a development strategy post-investment.

- The international investor not being motivated due to the small nature of deal/market.

Question 5 - What do you think the South African firms can do to attract more co-investment from international investors? What do they do well? Where do they struggle?

- Local investors don't broadcast success stories as well, and when they do they are perhaps not packaged in way that is interesting to outside investors. This could be attributable to cultural modesty or lack of experience.
- The South African diaspora is not leveraged sufficiently in the developed world to facilitate relationships or to invest in their personal capacities.
- There aren't active strategies to facilitate and foster relationships with international investors and there is very little talk in the community on that topic.
- This is a very open ecosystem in South Africa and would share quickly with an international investor, and does so when they are approached.
- South Africa needs to show capacity to deliver returns, which is ultimately what will attract foreign investors.

Question 6 - What do you think international firms could do to increase their chances of co-investing with South African firms into South African ventures? Where do they need to improve? What is their best chance of gaining the cooperation and interest from South African investors?

- Make their intent clear, and be upfront when approaching local investors. Clearly articulating the mandate of the fund/firm, and the type of investment and terms sought would also go a long way in improving chances.
- Research the local market as much as possible before approaching investors or considering an investment here.
- Network in local market and build relationships with investors, entrepreneurs and other service providers.
- Give a clear idea of the value they bring to the transaction and venture.
- Assist with analysing deals. Although they are perhaps smaller than in the developed world, going through the motions of looking at deals together builds trust and good will.

Additionally, the South African investors are genuinely curious as to how the large international players size up a deal and thus they would be willing participants in that process.

- It's important that the foreign investor comprehends the value of having a local South African investor involved substantively in the transaction.

5.4 Motivations

The listings below present the responses received during the interviews. It should be noted that the overall tone was positive towards the motivation to syndicate internationally.

Question 7 - Please explain the rationale behind your firm's reluctance, or conversely, support of engaging with international investors to co-invest in South African ventures?

- The ecosystem is a little isolated in South Africa and many haven't spent much time contemplating international syndication or fostering those relationships.
- The local practitioners are very open to internationally syndicating if there is a strategic fit and the international investor helps in execution of a business plan, brings a strong network to the table, or can facilitate future exits, to name a few. Presently, a purely financial investor would be accepted but that is the case due to the current dearth of entrepreneurial capital in South Africa.

Question 8 - When you consider syndicating with investors from developed countries, does your analysis of what we've discussed in this interview change based on the country of origin of the firm/fund? If so, how? If not, why do you perceive the country of origin to not be a material factor?

- US or European seemed to be slightly preferred. The preference for US and Europe (and UK) was that the deal flow they see is tech enabled, and the majority of the large exits in that space are in those markets. Particularity, the preference for US co-investors was cited by two respondents was attributed to large and common exits in the US.
- Open so long as there is an *angle* and value to having the investor (i.e., access to that market). It's all about the value that particular investor brings to that particular transaction.

- Language and cultural barriers were cited as potential issues if the foreign investor was not English-speaking and/or familiar with Western ways of doing business.

6 Discussion

6.1 Introduction

The results from the interviews indicate that the South African venture capital professionals are largely willing and ready to syndicate deals with their international investment colleagues, with a few caveats. The benefits they cited as inherent to internationally syndicated venture capital transactions are supported by the limited but burgeoning body of international research. The respondents explicitly state a high motivation and desire to take on international co-investment partners. The categories of benefits where the vast majority of responses fell were: access to new markets, expertise and knowledge sharing, stamp of approval, and access to capital. These response categories are unpacked below.

The interviews also provided valuable direction to this research on possible constraints to more internationally syndicated venture capital deals closing in South Africa. Local practitioners, according to this research, believe that the following four categories of constraints are most prolific: unsupportive regulatory environment, negative perceptions of investing in Africa and South Africa, relatively small deal sizes, and lack of quality entrepreneurs/bankable deals. These response categories are unpacked below.

Shaping the ensuing discussion is a realization by this researcher that the study of syndicated investments, especially early-stage internationally syndicated investments, is wrought with difficulty. As described by Jaaskelainen (2006), the syndication of investments is an inherently multilevel phenomenon combining aspects of contracting, venture development, venture capital firm strategies, partnership formation and interorganizational networks. With that understanding, the analysis below describes and unpacks the aforementioned categories of interview responses and findings in a manner consistent with the existing body of international research in the fields of domestic and cross-border syndication of venture capital investments.

6.2 Benefits & Motivations

The results of the interviews indicate that the South African venture capital investors perceive and appreciate the value inherent in internationally syndicated venture capital transactions. When asked about the benefits of such transactions, four categories of responses were apparent. Again, those categories are:

1. access to new markets,
2. expertise and knowledge sharing,
3. stamp of approval, and
4. access to capital.

Motivation of the local practitioners to form international syndicates also appears to not be an issue, as the interviewees were unanimous in their positive attitudes towards entering into such transactions. While the overall responses indicated an ability and willingness to enter into such transactions, there are some caveats to that conclusion which are also unpacked herein.

6.2.1 Access to New Markets

All of the interviewees responded that a prime benefit and motivation for having an international investor is a perception that the venture would be able to more easily and quickly enter and transact in markets outside of South Africa. This ameliorative effect was thought to be especially prominent in the markets where the international co-investor operates. They generally believed that the international expansion would improve revenues and returns, and increase the venture's likelihood of having a successful exit once it had scaled internationally.

The respondents indicated an understanding that having foreign investors inherently brings advantages which increase the value of a South African venture. The research below confirms and in many ways may explain the rationale for the interviewees' views in this area.

Devigne et al. (2010) released a white paper titled, *Cross-border venture capital and the development of portfolio companies*²³. The paper was concerned with how cross-border venture capital investors, as opposed to domestic investors, influence the development of their portfolio companies. To address that research question, a longitudinal study of 692 European technology-based companies was undertaken, tracking mostly sales from the year of initial investment up to seven years after that investment. The findings show strong support for their conclusion that ventures with a foreign investor exhibit higher sales growth, compared with companies backed by domestic investors. The researchers also looked at companies backed by a syndicate of international and domestic investors; these companies exhibited the highest level of sales growth in the sample.

The following supporting research was used to corroborate and explain the above findings. First, the foreign investor provides direct and relevant knowledge of certain foreign legal and business issues (Makela & Maula, 2005). Second, the foreign investor may provide portfolio companies access to their international networks, thus reducing the *liability of foreignness*, which is likely to foster international growth (Makela & Maula, 2005; Yli-Renko et al., 2002). Lastly, a foreign investor may provide the benefit of an endorsement which will often legitimize a company and makes mobilizing resources in the new markets easier (Stuart et al., 1999; Makela & Maula, 2005; Hursti & Maula, 2007).

Providing additional support to the notion expressed that investors with expertise and networks provide value to a venture as it expands to other markets is a 2013 report by DHL and IHS²⁴ titled, *Internationalization – a driver for business performance*. SMEs across 12 countries, including the G7 and BRIC economies (plus Mexico), were surveyed and interviewed. The purpose of the report was to glean insights into what makes SMEs internationally competitive. The table below describes one of the findings of the online survey administered to 410 respondents which is relevant to the research at hand.

²³ Many of the findings and methodologies of this research were peer-reviewed and published in the 2010 edition of *Frontiers of Entrepreneurship Research*. The working paper was also presented on several occasions.

²⁴ IHS provides industry data, technical documents, custom software applications, and consulting services to international clients. It is an NYSE listed company with USD 1.3bn in revenues in 2011.

Table 6: Looking at the last two years, what were the three main challenges you encountered when developing exports?

Top five challenges when exporting			
Challenges	G7 international high-performing SMEs	BRICM international high-performing SMEs	International high-performing SMEs
Establishing contacts with foreign partners and/or a foreign customer base	24%	21%	23%
Lack of knowledge of foreign markets	14%	29%	19%
High customs duties in the destination country	12%	15%	13%
Regulations in the destination country	15%	0%	10%
Quality of logistics services	8%	10%	9%

(Source: 2013 DHL and IHS SME report)

The top 2 challenges identified for exporting abroad, from SMEs who already were successfully doing so, were establishing contacts with foreign partners and lack of knowledge of that foreign market. From the BRIC respondents, 21% and 29% identified the challenge, respectively. The report also found that BRIC countries are more likely to trade internationally than their G7 peers. One explanation for that phenomenon is that emerging market SMEs must often trade internationally to become a substantial business given the relatively small domestic markets in which they operate.

The interviewees also exhibited an understanding and appreciation of the benefit of increased exit potential to international syndication. Two respondents went as far as to say that the reason they showed a bias toward co-investing with US based investors is the desire to tap into the exit opportunities available in that market. The research below confirms and in many ways may explain the rationale for the interviewees' views in this area.

Possessing an international investor involved in a venture, and/or a management team with significant international business experiences, increases the likelihood of a successful IPO in

a foreign market to the venture. A 2003 study published in the *Journal of Business Venturing* by Hursti and Maula proves this propensity. The study begins with the proposition that venture capital is likely only to flourish where IPOs are a possibility. This is the case due to the high valuations (and thus high IRRs attributed to ventures which lists) associated with IPOs, relative to the other methods of exiting an investment. Without an IPO as a viable exit option the returns aren't as great to the investor and the high risk of making an early stage investment is more difficult to justify. The researchers found a *home bias* inherent in many domestic equity exchanges which increases the complexities to a foreign venture attempting list on that exchange. Further, they found that the likelihood of a foreign IPO was positively correlated to the international experience of the management team, whether the business seeking the foreign IPO had existing international operations, and the presence of foreign venture capitalists and/or ownership. The foreign exchange's *home bias* is reduced most prominently in the market where the investors operate, but also in all other foreign markets.

South Africa does not have a strong IPO market. Although the Johannesburg Stock Exchange (JSE) in South Africa is the largest on the African Continent, globally it is the 18th largest, with a market capitalization of ca. USD 903bn (much of which is attributable to mining and natural resource companies). By increasing the chances that a South African venture has of listing on a foreign exchange, the investment proposition changes dramatically. In South Africa, trade sales are presently the most viable mechanism to exit an investment. While more success stories are needed, a recent and notable exit provides hope. That exit was a USD 110mn trade sale of Fundamo to VISA in the US which was led by Mark Shuttleworth's venture fund called HBD.

6.2.2 Expertise and Knowledge Sharing

The interviewees indicated that expertise and knowledge sharing were key drivers and benefits of internationally syndicated venture capital investments in South Africa. They recognized that in South Africa, practitioners tend to be generalists while in the more developed economies, due to competitive and other forces, people and firms often specialize. The local venture capital industry is new and as such value was recognized in

having international investors to verify local best practices, and suggest new and perhaps more effective deal approaches. Also mentioned was the perception that transaction costs are reduced where the foreign investor could more easily evaluate the merits of the business and investment, including the expansion opportunities of the business.

The interviewees perceived the value of their local expertise to be of high value in de-risking the transaction, and reducing costs of due diligence and other transaction costs. The respondents largely felt that their value was amplified in a place like South Africa which often requires more *hand holding* of entrepreneurs and young businesses than in more developed ecosystems. Prior research in this area largely confirms these perceptions, and that research is explained below.

As to the portfolio company, the aforementioned 2010 whitepaper titled, *Cross-border venture capital and the development of portfolio companies* illustrates the advantages. Again, the findings showed that by often sharing information and expertise at various levels of the transaction, returns were improved through increased sales/revenues to the venture and also improved were the downstream exit results.

In *Determinants of Cross-Border Syndication: Cultural Barriers, Legal Context, and Learning*, Meuleman and Wright (2008) showed that private equity investors (including venture capitalists) often use syndication to overcome cultural, legal and other nuances of the local market. They also found that as the foreign firm gained local knowledge through transactions and other experiences, the use of syndication would often diminish. The gleanings were derived from an analysis of 754 transactions, by 69 different firms. All of the investors in the sample were UK based, and investing into various European countries over the period from 1990 to 2005. The majority of the transactions involved buyouts, thus making the results not perfectly generalizable to this research. It is likely that Meuleman and Wright (2008) understate the importance of knowledge sharing for purposes of understanding venture capital transactions. This is the case because early-stage investments require more handholding and monitoring, support function budgets are smaller due to reduced fund sizes, and competent expert advice can have a greater impact in a company which is in the process of forming.

The local investor is often tasked with the ongoing monitoring of the investment, and assisting in the day-to-day management issues of the venture. The importance of the syndicate relationship in reducing these monitoring costs is illustrated in the previously described research by Makela and Maula (2008) titled, *Attracting cross-border venture capital: the role of the local investor*. Because the local investor is closer to the venture, and has valuable local knowledge, it is often able to monitor and support a venture more effectively and cost-efficiently than the international counterpart. Similar research by Dai et al. (2012), and Fritsch and Schilder (2008), also confirm these findings.

The existing body of research supports the idea that developed world investors are valuable to a transaction due to their highly specialized knowledge. Two published pieces which implicitly illustrate that proposition are *Reconsidering the venture capitalists' "value added" proposition: An interorganizational learning perspective* by Busenitz et al. (2004), and *Venture capital and the professionalization of start-up firms: Empirical evidence* by Hellman and Puri (2002). In relatively underdeveloped venture capital markets, one would expect the specialized value of more experienced foreign investors to be of even more importance than these research pieces suggests as they looked mainly at developed world transactions.

In South Africa, it is unlikely that the value of the international investor will diminish anytime soon. As illustrated in the surveys administered to South African practitioners by Portman (2013), the focus of the local industry has moved to later stage deals. As a result, local learning and expertise is likely not increasing at sufficient rates to lessen learning gaps with potential international co-investment partners. The South African practitioners seem to grasp the importance of knowledge and expertise sharing, and encouraging international syndication is one way of facilitating knowledge flows from the developed world to South Africa, to both the portfolio companies and local investors.

6.2.3 Stamp of Approval

The respondents believed that bringing in a high-status international investor could lead to better exit outcomes, higher likelihoods of successful future funding rounds, and instant local prestige. This they attributed to the *stamp of approval* effect that certain investors possess to validate a local portfolio company. They noted that the positive effects would manifest most prominently when the international investor itself had a high-status. Only one of the interviewees mentioned the stamp of approval effect in the converse direction. That being that by having a local investor with a high-status, many of the same benefits attributable to a high-status international investor can also shift to the venture.

Much of the research on status and its impact on business and relationships springs from the seminal research in that field by Podolny (2005). Two relevant pieces from the literature on status transfer and venture capital are analysed below.

The first, a 2010 piece published in the *Academy of Management Journal* by Guler and Guillen titled, *Home-country networks and foreign expansion: evidence from the venture capital industry*. Using data on the foreign market entries of 1,010 US venture capital firms from the VentureXpert database, robust support was found for the notion that social status of the international investor has a material effect on investment performance. The social status transfer, they argued, is important as it involves the imagery of a hierarchy of position which assists in attracting capital and negotiating with suppliers, along with other important advantages. A limitation of this study for this research's purposes is that it involves US based venture capital firms which expand through opening offices in foreign markets, not through international syndication. Expanding through opening an office means that the high-status international investor maintains control of its brand, and may be more likely to bring further resources to the transaction to protect the brand's perceived high-status. In a syndicate arrangement, it's conceivable that the high-status investor, having less *skin in the game* may be less incentivized on this front. Even with those limitations, the principle that high-status firms can transfer that status to ventures and partners in other countries is shown, and helps explain this research's interview findings.

An earlier piece by Stuart et al. (1999) looked at the rates of IPOs, and market capitalization of IPOs in 301 young biotech venture capital backed companies²⁵. They showed that those ventures with prominent and high-status affiliates and investors perform better. A core finding was that young companies with prominent business partners perform better than comparable firms that lack such partners. This phenomenon was attributed to status transfer, which builds confidence about the venture among suppliers, customers, employers, collaborators and investors. Simply put, high-status firm have likely earned their status, in one way or the other, and are thus better equipped to provide value-added advice and services to the venture.

When co-investing with high-status international investors the benefits which can accrue to the venture and local investors are supported by the interviews in this research, and by the body of academic literature. One implication of this finding is that when internationally syndicating, it would behove the South African investors and/or venture to seek out high-status foreign investors. The status transfer that occurs to both parties has been shown to carry substantial benefit to the portfolio company, making future capital raises easier, and IRRs to the investors more attractive.

6.2.4 Access to Capital

A common refrain vis-à-vis benefits of international syndication from the interviewees were in the category of improved access to capital. They acknowledged that the local venture capital ecosystem is thin and that access to capital is a significant challenge. They believed that having a gateway to the international capital markets would allow for more deals, larger deals, and to more easily and effectively make follow-on investments. A preference for strategic investors (i.e., those who bring more than just capital to the table) was strongly expressed. In this vein, two interviewees indicated they would only reluctantly co-invest with a purely financial investor.

²⁵ It's not entirely clear whether all of the firms in the sample were from the US. The supplementary data on patents in the field was derived on US companies.

The table below shows the venture capital investments in 2012 in selected countries outside of South Africa:

Table 7: Risk capital available in selected markets

Country	Venture Capital Industry (Local Currency)	Assumed Exchange Rate	Venture Capital Industry (USD)	Companies Funded
US	\$26.5bn	1 to 1	26.5bn	3698
UK	£5.7bn	1 to 1.64	9.33bn	820
Germany	€521mn	1 to 1.37	714.5mn	748
			36.54bn	5266

(source: NAVCA, BVC and BVCA databases)

The impact of diverting only a small flow from those sources could have a dramatic impact on the local ecosystem. The 2012 SAVCA Venture Solutions VC survey shows that from 2009 to the first half of 2012, there were 103 venture capital transactions in South Africa, with a value of ZAR 835mn (or USD 83mn assuming a 10 to 1 exchange rate) invested over that period in the asset class. That level of activity represents a fraction of what was experienced in 2012 alone in the US, UK and Germany.

6.2.5 Motivations

The motivation to syndicate with international investors was very high and unanimous among the interviewees. Often they felt isolated in South Africa, and were especially open to this form of a partnership where they perceived the value coming from the international investor was more than capital, and if it was a strategic fit for the venture. Most of the responses were not biased in terms of which nation the co-investors derived, but 2 interviewees expressed an interest in investors from the US due to cultural and language similarities. These respondents cited a preference for a US investment partner also due to the perception that gaining access to markets, networks and exit opportunities in the US would be easier with such an investor in the consortium. Specifically one interviewee noted that the US market is vast, and most of the major tech-enabled exits come from US listings.

In terms of the country bias expressed by some of the venture capitalists in favour of co-investing with US based investors and venture capital firms, prior research does shed light

onto why this may be the case. Soderblom and Wiklund (2006) prepared a review of the relevant literature on venture performance for a UK government agency²⁶ with the aim of presenting and drawing conclusions from over 120 peer reviewed papers. One conclusion which these researchers derived is that due to the breadth of the US venture capital markets, firms and investors in the US will generally have stronger screening mechanisms, existing strategic partnership, higher deal flow, superior ability to structure investments, and strong negotiating skills relative to their UK counterparts. The UK is the second largest venture capital market in the world, so there is at least a suggestion that these conclusions would hold for other European and developed markets.

Another conclusion of that literature review was that US firms value the contributions of a local co-investor more than their European counterparts (see Schwienbacher, 2008). One reasons for this, they discussed, is that European venture capitalists are less active and limit their value-adding ability to making deals, whereas the Americans tend to add value through actively monitoring and supporting portfolio companies. As evidence for this conclusion, they point to a study by Sapienza et al. (1996) which surveyed the backgrounds of venture capitalists in the UK and found that most had banking and financial backgrounds, while their counterparts in the US contained more diversity and participants with entrepreneurial and other technical backgrounds.

The interviewees said emphatically that they are motivated to internationally syndicate, and it's beyond the scope of this research to question those seemingly genuinely-held assertions. Assuming that motivation is not an issue, the issue of country bias was identified in the course of the interviews. A scan of the available literature shows that the not often expressed bias towards co-investing with US investors has logical underpinnings supported by the literature.

6.2.6 Caveats

Although the interviewees in the sample exhibited a desire to syndicate internationally, and recognized the benefits, there are some notable caveats to this research's findings that

²⁶ The Small Business Services (SBS) agency.

South African venture capital investors are ready and willing to syndicate with their colleagues in other markets. These caveats may cast some doubt on the readiness and willingness assertion, and also help to indicate areas to be explored in future research. Those caveats are firstly, that there is evidence that South African investors may be inclined to withhold the best deals from their international investor colleagues. Second, South African venture investment managers may be focused on too many factors other than IRR so as to be a deterrent to attracting international conventional co-investment partners. Lastly, the benefit of increased on-going commitment in internationally syndicate backed ventures was not raised in the interview responses which, although not likely a material omission, is worth exploring.

6.2.6.1 Cream Skimming

Cream skimming is the notion that comparing international venture capital returns to those in more developed economies is difficult due to venture capitalists in smaller markets only funding the best and brightest ventures, leaving the rest unfunded and thus not part of the return profile for the country (Guler & McGahan, 2006). Going further, the aforementioned Guler and McGahan (2006) research cited a key impediment to cross-border syndication being that lead investors may choose to not solicit foreign investors in an attempt to not dilute favourable future returns. Indirectly, this suggestion that *cream skimming* and other agency type problems inherently slow rates of international syndication is supported by other research (Admati & Pfleiderer, 1994; Filatotchev, et al., 2006).

Cream skimming may be relevant to this research and analysis due to the interviewees expressing a slight propensity to keep the good deals for the local investors, while allowing international investors into those deals only when the strategic value they bring is clear. This is a natural and human phenomenon, as represented by Guler and McGahan (2006) and one not unique to South Africa. Cestone et al. (2007) found that the greater the experience gap between the investors, the more a premium the less experienced lead investor had to pay (by way of reduced valuation and dilution of certain rights) to entice the experienced investor to join the syndicate. South African investors may intuitively understand this and rightfully be not eager to pay that premium.

The implication here could be simply that South African venture capitalists are similar to all other venture capitalist in that they want to maximize returns. They will seek other investors, either domestically or internationally, when it makes financial sense to do so. The concern, however, is that if *cream skimming* is occurring in South Africa then the international investors aren't seeing the best and most interesting deals, and the best local ventures may not be receiving the benefits which have been herein discussed of having a high-status foreign investor. These and other agency issues are important to understand, and the academic literature on agency issues' impact on international syndicate relationships is lacking and represents a sizable gap. The inclusion of *cream skimming* in this analysis of *caveats* is to highlight that gap, and suggest that given the unique history of South Africa, and periods of isolation from the international business communities, there may be more to this than at first meets the eye.

6.2.6.2 Attention to IRR

Almost missed in the analysis by this researcher was a recognition that the majority of the responses on international syndication revolved around benefits to the portfolio company, and not to the venture capital firm and investors. One strong exception was the investor in the sample with by far the most international experiences, who responded that returns and ability to deliver great returns should be at the centre of any syndicate relationship. He suggested throughout the interview that South Africa will receive more international investment when it more clearly demonstrates an ability to generate returns.

More research is required to understand whether this is a significant phenomenon. It could very well be that the other respondents implicitly understood the benefits at the investor-level, but opted instead to dance around that topic in favour of highlighting the benefits to the portfolio company. Alternatively, it could be a sign of something more serious and point towards a material issue which could hamper future international syndication in South Africa. A large majority of capital raised by venture capital funds operating in South Africa comes from DFIs or other sources which aren't 100% return driven. The entities normally have objectives which are to them as important as IRR is to the more sophisticated private investors in the developed world. Because DFIs are not as IRR focused as traditional

investors, it may be the case that South African venture investors weaned on investing DFI capital may find difficulty squeezing into and/or leading an international syndicate of traditional venture investors. As with *cream skimming*, the causal links from the interview data are not at first blush strong, and mentioned herein to highlight a potential issue that could be worth further exploration.

6.2.6.3 On-going Commitment Benefit

A benefit that was not mentioned in any of the interviews is the positive effect of on-going commitment to a venture backed by an international syndicate. By increasing the continued support and commitment to the venture, the likelihood of future and rigorous monitoring, further funding and incentive to leverage personal and professional networks on the venture's behalf theoretically should also increase (Makela & Maula, 2006). As with the scant mention to IRR, interpreting this omission is difficult and may not be a sign that the local practitioners aren't intuitively aware of this benefit. The fact that it wasn't mentioned does, however, suggest that an opportunity exists in this area to educate local practitioners on this benefit of syndicating internationally. It is a very powerful argument for co-investing internationally that shouldn't be ignored. A study in 2006 by Makela and Maula shows that benefit.

In that 2006 research, the *commitment theory* was applied to prior research in cross-border syndication, and conclusions drawn. *Commitment theory*, in this context, looks to explain the dynamics between individuals on an interorganizational level which impact levels of commitment to the various parties. It was found that having a local co-investment partner tends to induce higher levels of on-going support and commitment by the foreign co-investor. The effect diminishes with less distance between the foreign investor and the country of investment, if the foreign investor has other investments in that market, and where the deals are larger. In South Africa's case, it is quite far from any concentrated pool of experienced investors, and has not received much foreign venture investment so one would expect this on-going commitment effect to be strong.

6.3 Constraints

The interviewees recognized and provided valuable guidance in determining what the constraints and impediments are to the formation of more internationally syndicated venture investments in South Africa. Many of the responses were those which are familiar to most international transactions, and thus were largely excluded from further analysis.

Those excluded responses include:

1. fees to navigate regulations,
2. due diligence requirements of other investors,
3. incompatible mandates, and
4. disagreements as to the venture's development strategy.

First, the fees to navigate regulations as an impediment are relevant to any international transaction, and further analysis was deemed to be immaterial in gaining insights relevant to this research. Fees are also discussed indirectly in the regulations as constraints section and subsections.

Second, due diligence of new investors, especially when from foreign markets, is a cost consistent to any serious international transaction. Relating to the third point, when those mandates aren't compatible, the costs and difficulty in creating suitable structures can constrain the transaction. This is not a situation unique to South Africa, and this researcher did not uncover any convincing evidence which would debunk that assertion.

Lastly, there will inevitably always be a possibility of disagreements occurring as to future development plans of a venture. It's not clear to this researcher that those disagreements would be more pronounced when South African investors are involved, and no data or other indicator gives this researcher any cause to believe that such a condition exists.

The tenor of these four excluded points is confirmed in research by Du (2009) and can be lumped together. In that research, Du looked at 3,385 US companies that received first round financing from venture capital syndicates between 1995 and 2005. The findings suggested that companies with disparate investment partners in a syndicate were more

likely to fail early, took longer to become profitable, and had lower rates of IPO. However, the researcher also found evidence that investment partners who are different often help firms thrive long term, and this was attributed to the additional costs borne and knowledge exchanged early in the venture while working to make the venture work.²⁷ While not directly applicable to this research, Du (2009) supports the interviewees concerns that increased costs of having an international co-investor are valid constraints for consideration.²⁸

Two other points are omitted from direct analysis in this sub-Chapter, and those are: limited relationships with international investors, and a material preference for strategic over purely financial investors. Both points are addressed indirectly throughout the analysis, and specifically the constraining factor of limited relationships is dealt with in the Policy Suggestions chapter. The potential impact of not preferring purely financial investors is addressed directly in the Caveats sub-Chapter in the *cream skimming* analysis.

The remaining responses from the interviewees fell into four categories and are further unpacked in the ensuing 4 subsections, which are:

1. unsupportive regulatory environment,
2. negative perceptions of investing in Africa and South Africa,
3. small deal sizes, and
4. lack of quality entrepreneurs/bankable deals.

6.3.1 Unsupportive Regulatory Environment

The impact of exchange control regulations and IP protection regulations were mentioned by all of the respondents as constraining factors. Although not mentioned, BBBEE is a topic which was suggested in Brent et al. (2004) as a potentially material influencer on syndicated private equity transactions in South Africa which their questionnaire did not address, and that is one reason a BBBEE analysis is included herein.

²⁷ It should be noted that this research deals with international syndication, and the costs saved by having a local co-investment partner are substantial and would in most cases outweigh the costs associated with heterogeneous partnerships. Du's research looked at domestic syndication, and the model used to reach the conclusions included physical distance between investors as one variable of many.

²⁸ Du represents the only known research to this researcher in the space of syndication of venture capital investments that has findings showing negative attributes of syndication.

6.3.1.1 Exchange Controls

Exchange controls are government restrictions on the movement of currency between countries (SARB, 2013). In the developed markets, controls such as these are rare and where present lax. In the African Continent, however, they are quite common and South Africa is no exception.

A recent South African Supreme Court case involving the South African Reserve Bank (SARB) and renowned entrepreneur, philanthropist and venture investor Mark Shuttleworth has brought the issue of exchange controls and their effects (both positive and negative) into the limelight (Shuttleworth v SARB, 2013). In that case, the South African born Shuttleworth sued claiming exchange control levies were an unconstitutional taking and that the manner of enforcement represented a violation of the due process rights of South Africans. The impetus for the suit was the desire to reclaim a levy enforced by SARB to the tune of ca. USD 30mn. Shuttleworth lost on both counts, and his arguments and subsequent holding by the South African court offer fodder for understanding exchange controls in the context of international syndication.

South Africa has long employed exchange controls to combat capital flight and to ease balance of payments pressures, and the most stringent enforcement of these measures came in in the 80s and 90s. During that period, the hold on the government by the Afrikaner Nationalist Party was waning and exchange controls were one tool utilised to prop up the apartheid government. The controls have been partially maintained since then, and remain one of the vestiges of the former government which the ANC has opted to not dismantle.

The primary argument against free flows of capital, argue some governments and reserve banks, is that controlling those flows gives economies more stability and independence. Domestic monetary policy alone is ineffective in staving off capital account deterioration, inflation and currency devaluation for smaller economies in a global environment of seemingly endless rounds of quantitative easing (The Economist, 2013).

Views which oppose exchange controls are often political and fairness based, and the primary financial argument deals with investment irreversibility. By taking away the ability to easily repatriate funds, investment is deterred (Farrell & Todani, 2004). Additionally, as cited in the Shuttleworth suit (Shuttleworth v SARB, 2013), controls can also make running philanthropic and business transactions outside of South Africa very difficult. Large institutions and banks in South Africa avoid these layers of red tape and levies often through opening *shell companies* in countries like Mauritius to run their international operations and transactions. This of course results in a loss of jobs and tax revenues to South Africa. Unfortunately, opening *shell companies* in other countries is not a viable option for most small and medium sized job creating businesses who desire to transact outside of South Africa, or attract foreign investment.

Exchange controls in South Africa have been loosened considerably since 1994. The main hurdles remaining which would affect an internationally syndicated venture capital transaction in South Africa are the requirement to receive permission from SARB to dispose of assets which non-residents are owners; borrow locally for companies owned 75% or more by non-residents; pay remittance of royalties, license fees and patent fees to a non-resident; pay dividends and interest to non-residents in certain instances; invest outside of the country if a South African corporate; import and export in certain instances; and more. Adding more meat to the skeleton, one of the interviewees specifically mentioned the difficulty of arranging debt transactions with international investors²⁹ into South African businesses. The reason for this is that each interest payment to the international investors can be required to go through the SARB approval process often making the cost of debt transactions prohibitive. This matters because adding debt to the capital structure is a potent de-risking measure which can help induce investment and reduce the weighted average cost of capital. One of the difficulties in researching this sub-topic, and in complying with SARB regulations, is that the rules are not clearly spelled out. It seems to this researcher³⁰ that the SARB is given a good deal³⁰ of discretion in interpreting and enforcing the provisions.

²⁹ Europeans in particular appreciate debt-like investments in early-stage ventures.

³⁰ The researcher is a US trained and licensed (inactive) attorney possessing the degree of Juris Doctorate.

The impact of exchange controls on the international syndication of venture capital investments in South Africa is potentially profound, and not well researched or described. First, at the venture attractiveness level, South African ventures are placed at a disadvantage out of the gate when looking to trade abroad and internationalize. The exchange control hurdles are time consuming from a compliance standpoint, and assuming the transaction or capital flow are approved negatively impacts the return profile of the investment. Shuttleworth, a powerful and wealthy South African was unable to comply and remain as profitable as he desired. Large institutions like Standard Bank in South Africa have voted with their feet and run their international transactions in places like Mauritius to avoid the levies and red tape imposed by the SARB. These costs and preventative measures affect profitability.

Second, exchange controls can complicate the funding structure especially where international debt is involved. Debt interest payments must often go through the SARB approval process, and this can be a cost prohibitive and time consuming exercise.

Third, exits are a real issue vis-à-vis exchange controls and perhaps the most important. When it is time to sell a business, the transaction must be approved by SARB if to a foreign investor or if the company is to be listed on a foreign exchange. This has the impact of in many ways limiting the universe of purchasers of the successful future business to those residing and operating in South Africa. A smaller supply of potential purchasers usually will lead to lower valuations caused by reduced or no competitive tensions among interested buyers. For foreign companies who do ultimately purchase, the cost of complying with exchange control requirements are factored into the valuation and those costs will be borne by the entrepreneurs and original investors. This reduces the likelihood of the sale occurring in the first place, as well as the overall IRR on the investment. These impacts are felt early in the venture's funding process, and will ultimately lead to lower early valuations and other concessions to entice domestic or international investors.

6.3.1.2 Intellectual Property (IP) Protections

Kaplan et al. (2009) state that in general IP protections in South Africa are quite strong and easy and relatively inexpensive for which to file applications. South Africa normally ranks high among developing countries in terms of patent regime strength, and holds its own when compared to developed countries. This is good news, and investors considering an investment in a South African venture appreciate these protections.

In terms of constraining international syndication, the interviewees raised IP protections as an issue due to the difficulty in South Africa of exporting IP. It is important to be able to export IP for at least one important reason, exits. When restrictions are placed on a domestic venture's capacity to list on foreign exchange, or be purchased by a foreign entity, the entire value proposition for the investment is materially changed.

The exchange controls regulations, as previously described, apply in the case of IP transfers as IP is treated like capital. As such, the general rule is that no South African Intellectual Property may be exported outside of South Africa, or to a non-resident, without SARB permission. In addition to having to comply with exchange controls provisions, the IP will also go through various levels of approval through the IP regulations in the country aimed at keeping certain valuable IP in South Africa.

Savvy South African entrepreneurs and investors avoid these regulations by transferring all IP out of South Africa as soon as possible in the company's lifecycle. The earlier the better, as that is normally when the IP is valued at a low enough valuation to avoid these regulations and levies outright, or to reduce the ultimate burdens of compliance. The foreign company which then holds the IP will often license it back to the South African company. Once the IP is outside of the country, the jurisdiction of South Africa to tax or regulate that foreign company largely disappears. The purchaser and seller of the IP would then not be subject to exchange controls or levies. Although the profoundly negative effects of exchange controls and IP protections to the international syndication of venture capital investments in South Africa can be mitigated through proper planning, a layer of transaction costs and complexities are introduced which can distract the investors and

entrepreneurs from the ultimate aim of the partnership which is to grow a sustainable and profitable business.

6.3.1.3 Broad Based Black Economic Empowerment (BBBEE)

Interestingly, BBBEE was scantily mentioned by the interviewees as a constraint. The general finding that South African practitioners don't rate BBBEE as a material factor in domestic venture capital transactions is confirmed by research by Jones (2009) where South African venture capital and private equity practitioners were surveyed and selectively interviewed on a variety of topics. He noticed that in spite of a stream of literature indicating that labour law rigidity (including BBBEE) negatively impacts venture capital investments, it was not ranked as a material concern or issue with his respondents.

There are at least a few explanations for the omission of any discussion of BBBEE by the respondents in this research. First, the omission could be due to the fact that most startups and early-stage ventures don't have sufficient revenues to fall within the BBBEE code's jurisdiction. Second, startups which would be attractive to venture capitalists have the capacity to scale outside of South Africa relatively quickly, and/or don't rely substantially on government contracts, thus making a positive BBBEE score of relative unimportance.

Third, and a more controversial explanation is that due to the racial makeup of qualified entrepreneurs opting to devote themselves to running a startup and pursue financing it could be that local practitioners don't have enough experience dealing with South African black run venture backed companies to grasp the benefits which government preferences (or lack thereof) can have on a new venture. Some argue that BBBEE has had the unintended consequence of creating very attractive corporate jobs for qualified South African blacks, making entrepreneurialism and the risk associated with that choice unpalatable relative to the multitude of other options. This sentiment has been expressed by the brother of a former South African post-apartheid President Thabo Mbeki, and he (in)famously has argued that "...it [BEE] strikes the fatal blow against the emergence of black entrepreneurship by creating a small class of unproductive but wealthy black crony

capitalists made up of ANC politicians, some retired and others not, who have become strong allies of the economic oligarchy.” (Mbeki, 2009: 61).

Assuming this later theory has credence, the fact that many corporate jobs are largely out of reach for a significant swath of white male South Africans could be further confounding the problem. These white male South Africans are often forced to *emigrate or innovate* by starting and seeking funding for an entrepreneurial venture of their own. One of the worst case scenarios for South Africa could be to create a class of largely white entrepreneurs with limited support and relationships to the various government actors, and a class of largely black South African corporate employees without a desire to receive the numerous levels of support in starting and growing entrepreneurial ventures offered them by the South African government and other institutions. Lingelbach et al. (2009) also noticed and described this trend, and attributed the fall of venture capital in South African in part to the growing divide between the predominately white investors and entrepreneurs, and mostly black government actors in the mid-late 90s.

The omission of BBBEE as a constraint to international syndication in South Africa is interesting to this researcher. It’s interesting because the way in which BBBEE shapes transactions, shareholdings, and the ability of the venture to compete in South Africa should be a material consideration. To begin the analysis of that impact, a basic description of a typical BBBEE transaction in South Africa is proffered to serve as a backdrop. In order to gain BBBEE points, which are used to increase the likelihood of receiving government tenders and other competitive advantages, companies will sometimes engage in a sale of equity in order to increase the percentage of the company owned by non-white South Africans. The new owners, if they fall into a *previously disadvantaged* category (e.g., black South African, coloureds³¹, some Chinese, and Indians) will add to the company’s BBBEE scorecard which leads to preferential right on a number of levels.³² Generally, the BBBEE partner does not contribute its own capital. Instead, a bank is brought into the transaction

³¹ The description of a group of people in South Africa attributed to a variety of lineages. The description while offensive in the US and other countries is common and widely accepted with no negative connotation associated with its usage in South Africa.

³² Additionally, other companies receive points for doing business with high-scoring BBBEE companies so transactions with private sector companies can also become much easier and more profitable.

to lend the BBBEE partner capital to then purchase shares from the company. The shares are held by the bank as collateral, and personal guarantees are then offered by the company promising repayment. The BBBEE partner repays the bank principal and interest payments with dividends received. These transactions can become quite complicated and tailor-made to individual situations. However, most of the BBBEE transactions which this researcher has reviewed resemble the aforementioned arrangement.

Theoretically, all parties benefit in such a transaction. The BBBEE partner receives equity in a company and takes no risks. The bank receives interest and has guarantees and collateral protecting its downside. The company increases its BBBEE score and thus is able to more effectively compete in the South African marketplace. Lastly, society is improved as more previously disadvantaged categories of people have a stake in the economy.

An understanding of this structure helps illuminate the practice's potential impact on internationally syndicated venture capital backed transactions in South Africa. From the foreign investor's perspective, the transaction will inevitably seem unusual and in many ways incongruent with their views of how a company ought to be structured and how value is created. Allocating shares based on primarily racial considerations is not common in the more developed markets, and the complexity of many of the transactions could scare away an investor not familiar with the practice.

The foreign investors may also struggle to fit into a syndicate without damaging the company or lowering its existing BBBEE score. When new shares are issued to the international investor the diluting effect of that transaction could damage the management team's incentive and alignment with the company if their shareholdings become too low. The dilution can also cause the black-ownership percentage to reduce, thereby making the company less competitive in South Africa.

Monitoring after the investment has been made is a primary advantage of having a local co-investor, as has been previously discussed. If the BBBEE partner does not have the capacity or desire to monitor the local venture for the international investor, then that benefit is eliminated from the analysis of whether to internationally syndicate. Another investor with

that capacity in the local market could be brought in, but once again there may not be room, and if there is there may be consequences to diluting the BBBEE partners and management team. As such, ventures seeking to both secure international capital and have a high BBBEE score should seek out BBBEE partners who will either manage the venture or will be able and willing to offer monitoring services in line with the international investor's expectations.

So as not to be misunderstood, this researcher believes that the aims of BBBEE are mostly noble and that there are many benefits to the government action of encouraging and enforcing racial quotas in private businesses, especially in a country with South Africa's recent history. It is probably a necessary mechanism to correct the wrongs of the past and to bring more previously disadvantaged categories of peoples into the South African economy. Few would argue against that. This research aims to look primarily at the influence of BBBEE on internationally syndicated venture capital transactions, and has the luxury of ignoring and discounting the very important social and political rationale behind the code's creation.

6.3.2 Negative Perceptions

The interviewees occasionally mentioned negative perceptions of the investment climate in South Africa as a possible constraint to the formation of an internationally syndicated venture capital investment. This is likely not an irrational concern. In the years of 2012 and 2013, the South Africa's government bond rating was downgraded by Moodys to Baaa1; BMW halted expansion plans citing labour unrest concerns; high unemployment and inflation persisted; energy shortfalls remained an issue; and 44 striking mine workers were killed at Marikana by South African police which represented the single most lethal use of threat by a South African security force since 1960. Clearly, that list paints a dire picture to international observers.

These negative perceptions can be difficult (and expensive) to overcome. Investors are compensated for risks such as these through higher premiums and returns, which are often possible in a place like South Africa due to lower competition and abilities to take advantage

of more and deeper arbitrage opportunities. However, when the perceived risk is higher than the actual risk the South African investors and entrepreneur are theoretically giving too much alpha away to the international investor in compensation for that risk. It also removes from consideration many investment opportunities which would otherwise be attractive in an environment where risk was correctly perceived. As a more general point, perceptions such as these may even deter international investors from taking a close look at South Africa as an investment destination in the first place, especially into a risky asset class like venture capital.

It should be noted, the news hasn't all been bad. Recently, South Africa has been invited to join the BRIC consortium of nations, received direct foreign investment from WalMart, maintained its status as economic superpower on the Continent, seen the ascent of Cyril Ramaphosa³³ in the ANC party, and other positive items. South Africa is the most developed country in sub-Saharan Africa by a wide margin, and has first world calibre infrastructure and institutions. Serious investors looking to make investments in Africa would certainly have South Africa on their shortlist due to excellent management teams, relatively liquid capital markets and high standards of corporate governance.

Challenges around negative perception are not new to sub-Saharan African countries, including South Africa. However, the available evidence suggests that the tide is turning in favour of South Africa and other African countries. An article by the Economist in May, 2000 describing Africa as the *Hopeless Continent*, can be juxtaposed with a recent headline of *Africa Rising* by the same publication in December, 2011. According to UNCTAD statistics, Foreign Direct Investment (FDI) inflows to South Africa averaged only USD 1.9bn from 1994 – 2012. In the previous 5 years, from 2008 – 2012, the average FDI has been USD 5.24bn. Although these numbers are relatively small and indicate room for improvement, investments are occurring and South Africa is holding its own.

³³ Cyril Ramaphosa was elected the deputy President of the ANC in 2012, which is expected remain control of the government after the next election. He's considered one of the wealthiest South Africans, and made his wealth through favourable BEE induced transactions with Coca-Cola, McDonalds and other prominent companies operating in South Africa. Additionally, he was a key negotiator in the period leading up to the fall of the apartheid Nationalist government, and many believe and speculate that he was favoured by Nelson Mandela to follow him as the second democratically elected RSA President. Many believe this development to be positive due to Cyril Ramaphosa's pro-business leanings and prior history of doing business in South Africa with international partners.

Providing more clarity on this topic is the 2012 Deloitte & Touche and National Venture Capital Association (NVCA) report titled *Global Trend in Venture Capital: How Confident Are Investors?* In that, 440 survey responses were received from general partners with assets under management ranging from USD 50mn – USD 10bn. 72% of the responses came from non-US countries, and 70% were primarily engaged in venture capital. When asked about the overall confidence in investing in various regions and countries, here are the responses from the US and UK firms:

Table 8: US and UK based investors' level of confidence in selected countries

	US Respondents Score	Rank	UK Respondents Score	Rank
United States	3.87	1	3.56	1
Brazil	3.51	2	3.54	2
China	3.33	3	3.27	6
Israel	3.24	4	3.00	8
Canada	3.24	5	2.93	9
Australia	3.03	6	3.20	7
India	3.01	7	3.40	4
Singapore	2.96	8	2.80	10 (tie)
Taiwan	2.83	9	2.70	12 (tie)
United Kingdom	2.74	10	3.32	5
Germany	2.44	11	3.42	3
South Africa	2.25	12	2.80	10 (tie)
Japan	2.19	13	2.70	12 (tie)
France	1.90	14	2.58	14

(Source: 2012 Deloitte & Touche and NAVCA report on investor confidence)

While South Africa didn't rank in the top tier of investor confidence inducing countries, it was seen as more favourable than Japan and France for US investors. The UK respondents stated that South Africa was tied with Singapore in confidence inducing, beating out Japan, Taiwan and France. The aforementioned Economist headlines, UNCTAD data on FDI flows and the Deloitte & Touche survey results indicate that the perceptions of the investment opportunity in South Africa (and Africa at large) are improving and that many investors comprehend and are willing to accept these risks.

Irrespective of whether negative perceptions of Africa and South Africa are a material factor in constraining international syndications, there does seem to be work required in the area of dispelling negative stereotypes and reminding foreign investors of the positive aspects of doing business and investing in South Africa. More useful and reliable data, and evidence of prior profitable early-stage investments are required. Documenting and reporting early-stage investment success stories in a more sophisticated, open and complete way is a good place to start. The data and figures available to tell those and other stories are lacking. For example, the most comprehensive report on the private equity and venture capital industries each year in South Africa are compiled and presented by KPMG, and supported by SAVCA. KPMG is primarily an auditing firm, and many of its clients are the firms and funds interviewed. Additionally, as an auditing firm it may not be in the best position to analysis and compile this very important data. The lack of reliable and useful data is confirmed by this researcher while researching and completing this academic research.

6.3.3 Small Deal Size

According to the MoneyTree Report by PricewaterhouseCoopers LLP and the National Venture Capital Association (NVCA), in 2012 US venture capitalists invested USD 26.5bn in 3,698 deals. That is an average of USD 7.1mn per transaction. In contrast, the 2012 SAVCA *Venture Solutions VC survey* shows that from 2009 to the first half of 2012, there were 103 venture capital transactions, with a value of ZAR 835mn invested over that period in the asset class. That is an average of ZAR 8.11mn per transaction. Assuming an exchange rate of 10/1, that is USD 811k per transaction, or nearly 9x smaller than the USD 7.1mn in the US. Admittedly, Silicon Valley³⁴ is a juggernaut and hasn't been repeated elsewhere in the US, or world. A table comparing the two markets:

Table 9: Venture capital deal size comparison between US and SA

	Total Invested (USD)	# of Investments	Avg. Deal Size (USD)
South Africa (2009 - 2012)	83.5mn	103	811k
United States (2012)	26.5bn	3698	7.1mn

(Sources: 2012 SAVCA Venture Solutions VC survey and NVCA database)

³⁴ As a rule of thumb based on near-term historic data, it usually account for approximately half of the total capital invested into the asset class, and a third of the total deals in the US.

Perhaps more important than average deal size, is average fund size in terms of effects on inducing syndications. A primary driver of syndicating is to diversify a portfolio (Locket & Wright, 2000; Manigart et al., 2006). If a syndicated investment is too small to *move the needle* and impact the character of a portfolio, the motivation to syndicate is necessarily reduced. According to the NVCA database³⁵, at the end of 2012 in the US there were 4,716 venture capital funds holding USD 548.6bn of capital, representing an average venture capital fund size of USD 116mn. To put that into perspective, one average sized US venture capital fund could have made all venture capital investments in South Africa from 2009 to 2012 and still have USD 32.5mn of remaining capital.³⁶

Based on that quick survey of the US venture capital industry, the concerns cited by the interviewees are largely justified that small deal sizes in South Africa could be a constraining factor in influencing foreign investors to co-invest in South African ventures. Apart from the reduced diversifying effect which smaller transactions have on a portfolio, there is also the issue of transaction costs to consider which are more of a concern to venture capital firms as they tend to be smaller funds with smaller management fees, relative to the larger private equity funds (Buckley et al., 1992; Meuleman & Wright, 2008). When investing overseas, transaction costs necessarily increase for a variety of reasons. The research shows that syndication can reduce those costs, but perhaps not always to the extent necessary to induce an investment. As an example, a foreign firm contemplating an investment in a South African venture for the first time would likely insist on gaining an understanding of the local market, the selected management team and co-investment partners. This would require man hours, flight time and potentially overwhelming amounts of research. It may prove difficult to justify these costs unless the investment is truly exceptional, especially for a smaller sized deal.³⁷

A foreign firm contemplating an investment in South Africa for the first time could reduce those initial costs as described in the above example by having a South Africa strategy with a

³⁵ Available at: http://www.quandl.com/NVCA-National-Venture-Capital-Association/VENTURE_1_04-Fund-and-Firm-Analysis

³⁶ Comparison illustrated to highlight a point and the calculation doesn't include management fees, currency fluctuations, and other important variables.

³⁷ Incidentally, if the aforementioned *cream skimming* effect is active in South Africa, exceptional deals are unlikely to have been presented to that international investor in the first place.

plan to make future investments (i.e., spreading those initial costs over multiple future investments), investing in large first deals (i.e., reduce the relative size of the initial costs relative to the first investment), or have a trusted partner on the ground (i.e., allow the local team to handle those functions and levels of analysis). Whichever cost reduction strategy employed, it is quite clear that small deal size does have an impact on the difficulty of obtaining co-investment partners to South Africa, especially those who have not already absorbed the sunk costs of exploring and understanding the local investment landscape in South Africa and building the appropriate relationships.

6.3.4 Low Quality Entrepreneurs and Lack of Bankable Deals

The general consensus from the interviewees is that the entrepreneurs and management teams in South Africa are usually not as strong as those typically seen in the more developed markets. The impact is that foreign investors may not be satisfied and thus balk at investing into those teams, or require substantial improvements and changes. A term often used to describe the nature of the relationship between the investors and entrepreneurs in the interviews was *hand holding*. By this, the respondents meant that local entrepreneurs and ventures require very close attention and support, especially in the early-stages of the investments. This they felt could hinder internationally syndicated venture investment transactions due to increased monitoring and support costs, and a feeling that the amount of support and prodding required would not meet the expectations of the international investor. It should be noted, however, that the respondents were all generally satisfied with the level of the entrepreneurs in their pipelines, and all felt that they had suitable deal flow of bankable (or near bankable) deals.

Quantifying levels of entrepreneurialism in a society is challenging. Widely touted in South Africa when discussing the local entrepreneurial climate is the Global Entrepreneurship Monitor (GEM) report which is a report released annually by the University of Cape Town's Graduate School of Business³⁸. The GEM survey is an international project in which 69 countries participated in 2012, 10 of those were from sub-Saharan African countries. The primary measure of entrepreneurialism in the sample countries is the Total Early-Stage

³⁸ The GEM study in South Africa is a part of a larger study of entrepreneurialism globally led by Babson College and London Business School.

Entrepreneurial Activity (TEA) index. The data which forms the TEA score comes from uniform surveys administered to a random sample of 2,000 adults in each participating country. Other relevant data are used in the analysis to interpret and inform results.

In 2012, GEM reported that South Africa had the lowest level of TEA in sub-Saharan Africa, and internationally ranked towards the bottom percentile. A table from the 2012 report showing the relative ranking among other sub-Saharan African countries:

Table 10: GEM TEA scores for South Africa, compared to sub-Saharan Africa

Country	Nascent entrepreneurship rate	New business ownership rate	Early-stage entrepreneurial activity (TEA) = nascent + new rates	Established business ownership rate	Discontinuation of businesses
SUB-SAHARAN AFRICA					
Angola	15%	19%	32%	9%	26%
Botswana	17%	12%	28%	6%	16%
Ethiopia	6%	9%	15%	10%	3%
Ghana	15%	23%	37%	38%	16%
Malawi	18%	20%	36%	11%	29%
Namibia	11%	7%	18%	3%	12%
Nigeria	22%	14%	35%	16%	8%
South Africa	4%	3%	7%	2%	4%
Uganda	10%	28%	36%	31%	26%
Zambia	28%	15%	41%	4%	20%
Average (unweighted)	15%	15%	28%	13%	16%

(Source: 2012 GEM report on South Africa)

At first glance, the picture looks bleak for South Africa. However, a survey of other countries with strong and innovate economies shows that the TEA measurement as used in the GEM studies may have limitations when trying to understand the type of entrepreneurs which are attractive to investors. Gleanings from the GEM report showing TEA scores for South Africa, the United States, Israel, UK and Germany:

Table 11: GEM TEA scores for South Africa, compared to hubs of innovation

Country	Nascent entrepreneurship rate	New business ownership rate	Early-stage entrepreneurial activity (TEA) = nascent + new rates	Established business ownership rate	Discontinuation of businesses
SELECTED COUNTRIES					
United States	9%	4%	13%	9%	4%
Israel	4%	3%	7%	4%	4%
UK	5%	4%	9%	6%	2%
Germany	4%	2%	5%	5%	2%
South Africa	4%	3%	7%	2%	4%
Average (unweighted)	5%	3%	8%	5%	3%

(Source: 2012 GEM report on South Africa)

While South Africa ranks at the bottom in sub-Saharan Africa, it holds its own with these traditional powerhouses of innovation. It is tied with Israel, beats Germany, and is not far off from the UK and US. These confounding comparisons could be due to the broad definition of entrepreneurial activity which GEM utilizes. The GEM data categorizes a Bill Gates like entrepreneur in with a person selling bananas on the street corner in Uganda. This could call into question the TEA score as a valid measure of the capacity of entrepreneurs in a country to create and manage businesses with the ability to scale internationally and attract investment from serious investors. That proposition is supported by Lingelbach et al. (2009) where they argue that South African entrepreneurship is at a sufficient level to support a viable venture capital ecosystem, and that conclusion was derived after extensive interviews, surveys and analyses of the domestic venture capital ecosystem. This interpretation of the GEM data is also confirmed by the findings from this research’s interviews where it was found that there is a perception of sufficient levels of capable entrepreneurs, even though they may require more *hand holding* than would be preferred.

As this research report was concluding, a report from Ernst & Young (EY) was published which looked at entrepreneurialism in the G20 countries, of which South Africa is a member

(Ernst & Young, 2013). Their findings paint a mixed picture. On one hand, they found access to finance to be a lingering problem, and evidence that South Africa’s history of a lack of a culture of innovation³⁹ and rigid labour laws were still taking their tolls. On the other hand, South Africa has sound regulatory and tax processes for new businesses and starting a business is not very difficult. South Africa also has a world class financial market and a strong base of middle class consumers. When ranking the countries, South Africa fared well in the G20 and was in the second quartile of countries with Japan, Germany, France and the EU.

Table 12: EY 2013 Entrepreneurship Quartile Rankings

Quartile 1	Quartile 2	Quartile 3	Quartile 4
Australia	EU	Brazil	Argentina
Canada	France	China	India
South Korea	Germany	Mexico	Indonesia
United Kingdom	Japan	Russia	Italy
United States	South Africa	Saudi Arabia	Turkey

(Source: Ernst & Young 2013 Entrepreneurship Barometer report)

There is, however, evidence which supports the proposition that low-quality entrepreneurs in South Africa are an issue in attracting international venture investors. In the *2012 SAVCA Venture Solutions VC survey*, when asked about the inhibitors to the success of venture capital funds in South Africa, lack of skilled entrepreneurs and suitable management teams for ventures were cited as the top two inhibitors. These were followed by lack of exit mechanisms as the third most popular response. Interestingly, in the previous survey, lack of entrepreneurs was not mentioned as an inhibitor. The researchers squared those disparate results by explaining that the discrepancy could be justified by the increasing number of fund managers pursuing the same number of ventures, and not to a decrease in the levels of entrepreneurial activity. They believed the lack of suitable management teams and entrepreneurs was attributed to lack of exits and successful startups from which a pool of talent would naturally be developed and groomed. Providing further support, based on surveys of local practitioners, Jones (2009) found deficiencies in South Africa’s entrepreneurs to be the third most important issue limiting venture capital in South Africa.

³⁹ Supported by dearth of significant research output and patent applications in South Africa.

Whether there is a perception of lack of skilled entrepreneurs to run startups in South Africa, or an actual shortage, the jury is still out. The research in this area in South Africa is largely based on surveys and interviews of local practitioners and/or entrepreneurs. These results are the impressions of participants in an ecosystem which is relatively underdeveloped. As such, it's not clear how insightful the aforementioned findings are to understanding South African entrepreneurs in an international context, and whether they would inhibit international investors from investing with local co-investors into those ventures. The GEM data is the closest attempt to achieve that understanding, however as described it likely has limited applicability to understanding the type of entrepreneurs which would be attractive to sophisticated international investors.

7 Conclusion

This research set out to analyse the South African venture capital ecosystem, and specifically to assess the readiness and willingness of the local practitioners to syndicate internationally. Additionally, this research sought to ascertain and explain the constraints to international syndication in South Africa. This researcher found evidence to suggest that South African venture capitalists are ready and willing to syndicate internationally. They have a high motivation to syndicate with their colleagues overseas and they see the value in syndicating internationally. The primary categories of value which resonated, and were thus unpacked in this research, were access to new markets, expertise and knowledge sharing, stamp of approval and access to capital markets outside of South Africa. The body of international research in this area has also identified and described these categories either directly or indirectly.

The fact that South African venture investors comprehend these benefits, and express a high motivation to syndicate internationally suggests that the practitioners in the local ecosystem are ready and willing to syndicate internationally. However, there are caveats to that general conclusion which this research addresses. These caveats may cast some doubt on the readiness and willingness assertion, and also help to indicate areas to be explored in future research. Those caveats are firstly that there is evidence that South African investors

may be inclined to withhold the best deals from their international investor colleagues. Second, South African venture investment managers may be focused on too many factors other than IRR so as to be a deterrent to attracting international conventional co-investment partners. Lastly, the benefit of increased on-going commitment in internationally syndicate backed ventures was not raised in the interview responses, which although not likely a material omission was worth exploring.

From the interviews much guidance was proffered as to what the possible constraints to international syndication are in a South African context. Also shaping the analysis and selection of possible constraints to explore further were a number of primary and secondary sources. After eliminating constraints which are familiar to most international transactions in general, this researcher found the following constraints to be material and thus suitable for further analysis: unsupportive regulatory environment, negative perceptions of Africa and South Africa, small deal sizes, and lack of quality entrepreneurs/bankable deals.

This research makes several contributions to the literature. First, this is the first known piece of research to address the relatively young body of research in the field of international syndication of venture capital investments in a South African or African context. To this researcher's knowledge, this study is the first to examine the suitability of a county's venture capital ecosystem for international syndication. It is also the first to address regulatory and other constraints inherent to a country which could inhibit these transactions. The approach taken in this research was pragmatic, making the final research document a tool for practitioners and policy makers to make these transactions more common and likely to occur in the future.

Second, this research is the first known piece to address the impact of indigenisation measures (e.g., BBBEE) on internationally syndicated venture capital transactions. In that analysis, this research also coined a term for the first time as known to this researcher, and that term is *emigrate or innovate*. *Emigrate or innovate* describes the situation in which many white male South Africans find themselves, and the impact of that situation on South Africa's venture capital ecosystem and suitability as a place for internationally syndicated transactions described. These findings should be particularly interesting to policy makers

and individuals who want to foster entrepreneurial support in a manner which will have a real impact, and also those who have as one of their aims to empower in a meaningful manner those from previously disadvantaged categories in South Africa.

Third, the findings herein suggests that the GEMs data may be wholly inadequate as a tool of measuring the type of entrepreneurial activity in a country which is attractive to investors. This researcher has found no other mention in prior academic research of this limitation, and as such this research is perhaps the first to call the utility of the GEMs data into question when using it to make business and investment decisions.

Fourth, this is the first piece of known research which describes what impact exchange controls and other similar regulations can have on internationally syndicated venture capital transactions. The findings can provide more clarity to practitioners trying to avoid the negative effects of such regulations, and also to regulators looking to craft regulations which don't harm the ability of South Africa to attract international direct investments into local ventures and entrepreneurs.

Fifth, this research offers the first review of the literature on the topic of venture capital in South Africa. By placing all of the research in that field in one chapter, it is now possible for future researchers to quickly comprehend the current state of research and to identify possible gaps where that researcher can make contributions.

Lastly, South African private equity and venture capital funders often have social impact and other governmental and governance objectives. There is a chance that the attention away from solely an IRR-based objective could pollute an investment ecosystem and could go a long way in explaining the relative lack of success of South Africa's venture capital investments. International and serious investors are IRR focused, and the differing paradigms could also make co-investing with investors from a developmental aid frame of reference challenging. This research is the first known piece to look, albeit in a glancing fashion, at that phenomenon and apply it to a cross-border venture capital investment analysis.

This researcher hopes the findings, efforts, and long hours of researching and writing inspire new research in the field of international syndication of venture capital investments in a South African or other context. The objective of such research should be to open up the international capital markets to South African entrepreneurs, allow foreign investors to participate directly in the *African growth story*, provide co-investment support to local investors, and increase the likelihood of more truly exceptional and global companies forming in South Africa and other developing markets. This is a win-win proposition and a pursuit which can have substantial long-lasting and near-term impacts in places like South Africa.

8 Recommendation for Future Studies

The findings of this research offer a multitude of insights into future areas of study.

First, a deeper understanding of the ability of South African ventures to scale internationally is important. The local market is relatively small, and developed world investors will likely want the venture to tap into other markets quickly. A longitudinal study of these ventures, looking at constraints to growth, actual sales growth, and other variables would offer interesting conclusions. This research is available on more developed markets, which would offer the South African researcher the template to conduct the research and a benchmark from which to draw conclusions.

Second, this research focused on South African practitioners considering international investment and their views on these transactions. Also useful would be a similar study of international investors looking at their perceptions of internationally syndicating with South African investors and ventures. In this vein, the only missing party from the analysis would be the entrepreneurs and management teams. Furthering the understanding of these three parties to internationally syndicated venture backed transactions could provide much insight.

Third, the networks of firms are shown to have the capacity to increase the business prospects and returns of ventures into which they invest. What about the

interconnectedness of venture capital fund managers with other fund managers? Do the presence of these relationships have a material effect on the likelihood of syndication, and the ultimate success of those syndicated backed deals? If found to be material, one could conclude that well connected venture capitalists are better backers of ventures as they are more easily able to access future funding (through attracting more investors) and strategic partners as the venture develops.

Fourth, the research in South Africa on the type of entrepreneurs that investors want to understand and back is lacking. The GEM data is interesting, but largely insufficient for these purposes for reasons described in the body of this research.

Fifth, exchange controls were cited as a primary impediment to enticing international investors to co-invest in South African ventures. The review of available literature on the topic confirms those findings. More research is needed to understand the impact of exchange controls (and IP protections) on these internationally syndicated transactions.

Sixth, the discussion in this research on the impact of BBBEE suggests that the codes aimed at correcting the injustices of the past could be in fact harming entrepreneurialism in South Africa, especially as it pertains to the categories of people these codes are aimed at lifting up. One way of many to study this phenomenon is to use Lingelbach et al. (2009) and their work as an underpinning. In that, they attribute the fall of venture capital in South Africa to the weakening relationships (embeddedness) between the government (mostly black) and the venture capital participants (mostly white). What about today, do these findings still hold and do they offer support for this model of venture capital emergence? Are the BBBEE codes (assuming they are having the effect of increasing entrepreneurial activity among the white population, and discouraging it in the black population) making venture capital less likely to emerge?

Seventh, the international literature is hollow in the area of risks and constraints to cross-border syndication. Given the youth of the research into the internationally syndicated venture capital investments, it's logical that the first bits of research would focus on benefits and drivers of the activity. This research takes an early step towards understanding the

phenomenon by identifying some constraints and impediments to international syndication in a South African context.

Eighth, Lerner (2012) warns governments against making direct investment and other decisions to support an entrepreneurial ecosystem. South Africa has historically behaved largely in ways proscribed by such research, and there is no documentation known to this researcher on the successes and failures attributable to the South African government's interventions to improve the domestic ecosystem. Credible research in this area would not only be novel, it would also have significant potential to sway legislative decisions moving forward.

Ninth, as the sample in this research was relatively small due to forces outside the control of this researcher (i.e., nascent venture ecosystem in South Africa, et al.), a future similar study of venture professional at a time when the industry is more mature could produce results which either confirm or contradict the findings herein. The fact that the local practitioners haven't been involved in many transactions may limit the usefulness of their responses in drawing conclusions on the local ecosystem and its suitability as a place ready for early stage international syndication activity.

9 Policy Suggestions

There is much that can be done from a public policy standpoint to foster and develop a more supportive environment within South Africa to attract more internationally syndicated venture capital investment activity. Obviously, elected and appointed leaders have to view each issue with a multi-focal lens, whereas this research and these policy suggestions have the luxury of excluding other important considerations from the analysis such as righting the wrongs of the past, creating a more equitable environment, effective tax policy, and others.

The respondents were asked what could be done to facilitate more internationally syndicated investments in South Africa, and their responses were helpful. They said that locals don't broadcast their success stories well and attributed this to cultural modesty or some other factors. Additionally, there aren't active programmes to facilitate connections

with foreign investors, or even to the diaspora living abroad. These people are often in a position to make or sway investment decisions in their new country of domicile. Lastly, they indicated that more research is required into the local industry and transactions to not only be able to make better domestic investment decisions, but also to more easily tell the domestic investment story to foreign investors. The more precisely and accurately that story can be told, they believed, the more likely it is that foreigners will invest and that when they do invest the required risk premium lower.

With those points in mind, below is a list of policy suggestions.

First, IP protections should be de-linked from exchange control legislations and thus making it freer to flow out of South Africa. A South African appellate court agreed and in the early-2000s held that to be the case, which was shortly followed by the enactment of legislation with verbiage to directly include IP under the prevue of the SARB control. By allowing IP to leave the country the incentive to invest in developing IP in South Africa is increased by both domestic and international investors.

Second, exchange controls could be eliminated altogether making the first point moot. Although the controls have been loosened since the ANC took over the government, this research shows there may be more work remaining. Exchange controls have the effect of limiting foreign investment, domestic investment, and hampering the ability of South African companies to transact outside of the country.

Third, much of the support provided by the South African government is through making actual investment decisions into South African ventures and businesses. The track record of these investments, coupled with research from such people as Lerner (2012), indicate that this is not an effective use of government resources. South African public policy should probably steer away from making the decisions of which ventures to fund, and instead act to create an environment where the businesses can flourish.

Fourth, there is very little data being collected on investment transactions, and those data which are available are often compiled by companies with their own interests and whose

core competencies aren't data collection and analysis. More financial and academic support should be applied to these measures. The US and other developed markets do a fine job of this, and many of the strategies used by foreign companies and governments to this aim would be instructive.

Fifth, as indicated in the interviews, relationships with international investors and South African investors are lacking. By encouraging and facilitating those relationships, one would expect more international investors to invest in South Africa. One way to approach this problem is to create an exchange programme whereby prominent international venture capitalists can spend time with South African investors. These relationships will form the basis for future internationally syndicated deals and build goodwill and trade ties between South Africa and other powerful trading partners. The benefits of those relationships in reducing transaction costs and encouraging co-investment is described previously and supported by prior research (Meuleman et al., 2009; Sorenson & Stuart, 2008).

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Appendix 1 – Interview Questions

Background (Demographics):

Name of company and/or Fund(s) _____

1. Position _____ of _____ person interviewed: _____
2. How many years has your Firm/Fund invested in early-stage investments: _____
3. How many investment professionals work for your firm?
4. What is the size of your fund (AUM)?
 - a. R10mn – R30mn
 - b. R30mn – R70mn
 - c. R70mn – R150mn
 - d. R150mn+
5. What stage do you invest (circle all that apply)?
 - a. **Seed funding** - (initial capital to start the business)
 - b. **Start-up capital** - (*Early funding used for setting up operations (hiring staff, renting office space, equipping the production system, etc.), commercializing intellectual property, and other activities.*)
 - c. **Development capital** - (*Finance used after start-up capital to further launch the business and grow market share in order to become profitable.*)
 - d. **Growth capital** - (*Equity type investments used to assist established but still high-risk ventures in expanding activity such as launching into foreign markets, creating new product/technology lines, accelerating production and/or acquiring competitors.*)
 - e. **Buyout funding** - (*management buyout, management buy-in and replacement capital*)
6. How many early-stage deals does your firm plan to fund in 2013 (calendar year)?
 - a. 0
 - b. 1
 - c. 2
 - d. 3+

Constraints

3. What do you perceive to be the constraints to international investors co-investing with SA investors, into SA ventures?

4. What would be your reservations to having international co-investors?

5. What do you think the SA firms could do to attract more co-investors from the international investors? What do they do well? Where do they struggle?

6. What do you think international firms could do to increase their chances of co-investing with SA firms, into SA ventures? Where do they need to improve? What is their best chance of gaining the cooperation and interest from SA investors?

Motivations

7. Please explain the rationale behind your firm's reluctance, or conversely, support of engaging with international investors to co-invest in South African ventures.

8. When you consider syndicating with developed countries, does your analysis of what we've discussed in this interview change based on the country of origin of the firm/fund? If so, how? If not, why do you perceive country of origin to not be a material factor?