DETERMINANTS OF CROSS-BORDER SYNDICATION: CULTURAL BARRIERS, LEGAL CONTEXT, AND LEARNING

Miguel Meuleman  
*Vlerick Leuven Gent Management School, Belgium, miguel.meuleman@vlerick.be*

Mike Wright  
*University of Nottingham, UK*

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ABSTRACT

Private equity (PE) has become an increasingly international phenomenon but there is a lack of research that looks at the process by which PE firms invest across borders. We aim to fill this gap in the literature by examining the role of cultural distance, legal context and organizational learning as determinants of cross-border private equity syndication. We examine these issues by studying the international expansion by later-stage UK PE investors into continental Europe over the period 1990 to 2005. Our results indicate that legal context and organizational learning are significantly related to the use of cross-border syndicates. Implications for theory and practice are suggested.

INTRODUCTION

Private Equity (PE) has become an international phenomenon in recent years. A disparate body of research on international aspects of PE has emerged across a number of disciplines comprising entrepreneurship, international business, finance, economics, strategy, sociology, and economic geography. The vast majority of this research has focused on cross-country comparisons, at both macro and micro levels. Major research gaps, however, exist in relation to work dealing with the international development of PE industries and the process by which PE firms invest across borders, that is, internationalize (Wright, Pruthi, & Lockett, 2005). An important, neglected issue in understanding international PE development concerns international or cross-border syndication.

In an international PE syndicate, local investors team up with foreign investors in order to invest in a portfolio company. The literature on PE syndication has mainly focused on syndication between local investors without providing a specific perspective as to why PE firms rely on cross-border syndicates when they internationalize (Brand, Amit, & Antweiler, 2002; Bygrave, 1987; Lerner, 1994; Manigart et al., 2006). A number of recent studies look at the issue of cross-border syndication in an early stage venture capital context. For example, using a grounded theory approach, Mäkelä and Maula (2006a) examine the role of local venture capital firms in attracting foreign venture capital investors. Further, in a related study Mäkelä and Maula (2006b) look at the antecedents of venture capitalists’ commitment to portfolio firms in cross-border syndicates. Lastly, Jääskeläinen and Maula (2006) study the impact of cross-border syndication on type of exit and exit location of the portfolio company. These studies, however, have not systematically examined why foreign PE firms rely on local partners through cross-border syndication when investing abroad. Addressing this omission is important to understanding the cross-border behavior of PE firms. Although informational asymmetries may be especially problematical when investing abroad, anecdotal evidence indicates that foreign venture capital investors sometimes prefer to invest alone when investing abroad (Mäkelä & Maula, 2006a). The main research question we address in this study, therefore, is why do foreign PE firms rely on local partners through cross-border syndicates when investing abroad?
To answer this question, we rely on a central, well-established assumption in the field of international business, namely that the knowledge required for a firm to operate in a foreign environment is different from that accumulated in its home country (Dunning, 1993; Johanson & Vahlne, 1977; Kogut & Zander, 1993; Vernon, 1979). While a firm may develop a wealth of industry-specific resources and knowledge, these may not be fungible into foreign markets (Anand & Delios, 2002). Rather, a firm may need to augment its resources and knowledge base when investing overseas through entering alliances. One major reason, therefore, why PE firms might syndicate their deals with local partners when entering foreign markets is to gain knowledge about the institutional environment (Bruton, Fried, & Manigart, 2005). In this study, we examine how cross-border syndication decisions are related to differences in cultural and regulatory aspects of the institutional environment.

An important question is whether PE firms are able to reduce legal and cultural barriers through learning. According to the staged model of international expansion (Johanson & Vahlne, 1977), firms learn as they internationalize and, therefore, gradually increase their international involvement. Using an organizational learning perspective (Cohen & Levinthal, 1990), we also examine the role of different types of experience in reducing barriers in the institutional environment thereby reducing the need to rely on local partners through cross-border syndicates. More specifically, we examine both the role of depth and diversity in a PE firm’s international experience in explaining a private equity firm’s cross-border syndication decisions. Further, we examine whether differences in the knowledge generating capacity of PE firms have implications for investing in foreign markets with local partners.

These issues are empirically examined by studying the international expansion of UK PE firms specializing in later stage buyout investments into continental Europe during the period 1990 to 2005. Buyouts involve an important variant of entrepreneurial ventures (Wright, Hoskisson, & Busenitz, 2000). Data are drawn from a unique, hand collected dataset maintained by the Center for Management Buy-out Research (CMBOR). The UK PE market is the largest in Europe accounting for some 52% of the whole European PE market in 2004 and is second in size only to the United States on the world stage. Whereas only a handful of players were internationally active at the beginning of the nineties, more than 40 players had invested into continental Europe.

The rest of this paper is organized as follows. First, we discuss the theory and provide our theoretical framework and related hypotheses. Second, we introduce the research setting of our study. The following section outlines the data and method used in the analyses. Next, we present the findings from the empirical analyses. Finally, we discuss our findings, conclude and outline potential avenues for future research.

THEORETICAL FRAMEWORK AND HYPOTHESES

The Nature of Cross-Border PE Investments

The international business literature maintains a central assumption namely that the knowledge required for a firm to operate in a foreign environment is different from that accumulated in its domestic market (Dunning, 1993; Johanson & Vahlne, 1977; Kogut & Zander, 1993; Vernon, 1979). The skills and resources possessed by a firm, therefore, may have limited geographical application because of differences between the host and home countries (Buckley & Casson, 1976). In the context of private equity investing, foreign environments will put special demands on the skills of the private equity investor (Wright et al., 2005). Private equity investing can be described as a cycle consisting of different activities: fund raising; deal generation; screening and
selection of investments; deal structuring; monitoring and value adding; exiting investments and returning capital to investors; finally starting over with the private equity firm raising new funds (Wright & Robbie, 1998). In an international context, some of these activities pose certain challenges to PE firms.

Given the specific knowledge requirements associated with investing abroad, working with partners in order to learn about the local environment represents a primary motivation for firms to enter alliances (Hitt, Dacin, Levitas, Arregle, & Borza, 2000; Shenkar & Li, 1999). In the context of private equity investing, relying on local PE investors through cross-border syndication might be attractive to foreign investors, because they have knowledge about the operation of the local market, including access to deal flow as well as dense networks of contacts and familiarity with different legal requirements.

Cross-Border Private Equity Syndication and the Institutional Context

Cross-border private equity syndication decisions are likely impacted by differences in the knowledge required to operate in a specific institutional context (Hoskisson, Eden, Lau, & Wright, 2000). Institutional knowledge is knowledge about the governance structures in specific countries, their rules, regulations, norms and values (Eriksson, Johanson, Majkgard, & Sharma, 1997). Relying on a classification proposed by Scott (1995), Bruton et al. (2005) describe three important aspects of the institutional environment for international private equity investing: normative, regulatory, and cognitive. We explore the role of cognitive and regulatory institutions in the context of cross-border syndication decisions.

Cognitive processes build from the culture of a society and shape individuals’ views of what is and is not possible (Scott, 1995). National cultures are often represented by building on the concept of values. Values refer to desirable goals and to the modes of conduct that promote these goals. They serve as standards to guide the selection, evaluation, and justification of behavior, policies, and events (Smith & Schwartz, 1997).

As PE firms are actively involved in monitoring and managing their portfolio companies (Wright & Robbie, 1998), cultural differences might require different approaches in dealing with the portfolio company. PE firms may attempt to replicate their domestic mode of operation when entering foreign markets which might not be appropriate given the specifics of the local market (Meyer & Shao, 1995). Leeds and Sunderland (2003) provide anecdotal evidence on the need for locally based PE personnel who are culturally attuned. One way to resolve problems related to cultural issues is to augment the private equity firm’s resources by relying on local PE firms through cross-border syndication (Mäkelä & Maula, 2006a). The task of managing and monitoring the portfolio company can be assigned to a local PE firm better able to manage the local management, labor force and relationships with suppliers, buyers and governments. A cross-border syndicate, therefore, resolves the foreign investors’ problem ensuing from cultural factors, though at the cost of sharing control and ownership. Therefore, we hypothesize:

**Hypothesis 1:** Cross-border private equity syndication will be positively related to the cultural distance from the host country.

One important aspect of the institutional environment in which PE firms operate is the regulatory framework of a country (Black & Gilson, 1998; Bruton et al., 2005; Jeng & Wells, 2000). There are several reasons why differences in legal environment might be related to the use of cross-border syndication. First, several studies in the PE literature have shown that the
fungibility of the contractual arrangements and operational routines specifically developed for a
certain country may prove problematic in their transfer to another country (Bottazzi, Da Rin, &
Hellmann, 2006; Kaplan, Martel, & Strömberg, 2005). For example, although convertible
instruments are a key feature of the US and UK PE markets, where common law codes permit
flexibility in the development of new financial instruments, this is not the case in civil code
countries which may prohibit such instruments (Cumming & Fleming, 2004). In order to deal with
the specifics of the legal environment, PE firms might prefer to work with local partners through
cross-border syndication (Mäkelä & Maula, 2006a). Therefore, we expect that PE firms investing
in countries with a different legal origin from that of the UK will be more inclined to rely on local
partners.

Second, owners’ interests receive different degrees of legal definition and protection,
specifically against the decisions of the incumbent entrepreneur or management team (La Porta,
Lopez-de-Silanes, & Shleifer, 1999; La Porta, Lopez-de-Silanes, Shleifer, & Vishny, 1998). This
line of research argues that owners’ rights are defined and protected in varying ways and to
different degrees depending on the legal tradition and, related to this, the development of its
capital markets (Black & Gilson, 1998). The best protection of owners’ rights is afforded by
English common law, followed by Scandinavian and German law, while the French legal tradition
provides the worst protection (La Porta et al., 1999). Markets in which owners’ rights are better
protected have evolved towards market-based financial systems as opposed to bank-based
financial systems (Ergungor, 2004). Foreign PE firms can attempt to deal with problems
associated with the level of investor protection offered by relying on local partners through cross-
border syndication. Local partners might have developed informal mechanisms in order to deal
with some of the problems associated with the legal environment.

As such, we expect that PE firms that invest in countries with lower levels of investor
protection will be more likely to rely on local partners through cross-border syndication. Therefore, we formulate:

Hypothesis 2a: Cross-border private equity syndication will be positively associated with
lower levels of investor protection in a host country’s legal system.

Hypothesis 2b: Cross-border private equity syndication will be positively associated with
the use of a bank-based financial system as opposed to a market-based financial system.

Cross-Border Private Equity Syndication and Organizational Learning

PE firms may be able to reduce cultural and legal barriers through learning.
Internationalization can be viewed as a process of learning and knowledge accumulation
(Johanson & Vahlne, 1977); (Barkema, Bell, & Pennings, 1996; Barkema & Vermeulen, 1998).
The main emphasis in the stage model is on experiential learning i.e. firms accumulate knowledge
about country specific markets through their ongoing activities. In the context of private equity
investing, private equity firms derive knowledge from prior investments and manifest their
absorptive capacity in their evaluation, selection, and management of investment opportunities
(De Clercq & Dimov, 2007). Cross-border private equity syndication is likely more useful in the
early stages of international investment when the firm lacks familiarity with the local market
(Guillén, 2003). After acquiring local knowledge through syndicating deals with local partners, PE
firms might be able to reduce institutional barriers. As such, PE firms may be in a better position
to invest alone in subsequent deals once they have gained experience. The incentive to invest
alone once this experience has been gained may be increased since syndicating with a local partner
may expose the foreign firm to contractual risks associated with interfirm cooperation (Caves, 1996). Given these costs and risks, the net potential benefits of cross-border syndicates are expected to decrease as the PE firm acquires knowledge in the foreign location. Therefore, we hypothesize:

**Hypothesis 3:** Cross-border private equity syndication will be negatively associated with the experience the PE firm has with the host country.

Both country specific and multinational knowledge are important for a firm’s internationalization process (Johanson & Vahlne, 1977). As firms invest in multiple countries, they gain multinational experience, i.e. experience with different countries. Multinational diversity exposes a firm to a rich array of environments with a broad array of institutional characteristics and a large variety of rivals, suppliers and partners which adds to knowledge accumulation and double-loop learning (Barkema & Vermeulen, 1998; Mezias & Glynn, 1993). This richer knowledge set likely results in a higher probability that the new knowledge required for a subsequent new international situation may have similarities with the current stock of knowledge in the firm (Eriksson, Johanson, Majkgard, & Sharma, 2000). Therefore, the need to rely on local partners to gain knowledge with the local environment will be reduced as firms gain multinational experience. Therefore, we hypothesize:

**Hypothesis 4:** Cross-border private equity syndication will be negatively associated with the multinational experience of the PE firm.

The knowledge generation capacity may impact the rate at which a firm acquires new knowledge about a country (Martin & Salomon, 2003). PE firms with less human resources in the form of fewer internationally experienced executives may require more time to gain knowledge, learn new roles and compete with existing firms and well-established local investor groups in foreign markets (Buckley, Pass, & Prescott, 1992). Therefore, PE firms with fewer human capital resources might invest in foreign markets with local partners for a longer period of time. PE firms with more executives will be able to commit larger resources to foreign market entry and establish themselves more quickly, thus reducing the need to rely on local partners through cross-border syndication. As firms with more human capital will be able to gain local country knowledge faster, we expect them to be less inclined to rely on cross-border syndicates. Therefore, we hypothesize:

**Hypothesis 5:** Cross-border private equity syndication will be negatively associated with the human resource base of the PE firm.

**DATA AND METHODS**

**Empirical Setting: UK PE Firms Internationalization Process into Continental Europe**

The foregoing hypotheses are empirically examined in the context of buyout investing by UK PE investors into continental Europe over the period 1990 to 2005. The UK PE market accounts for some 52% of the whole European PE market in 2004 and is second in size only to the United States on the world stage. From the beginning of the nineties onwards, the number of UK PE investors moving into continental Europe has increased steadily. The buyout deals for this study are identified through a hand collected database maintained by the Centre for Management Buyout Research (CMBOR) at the University of Nottingham. This database covers the entire population of buyouts in the UK from the beginning of the 1980s onwards. Further, this database also contains the international buyout investments by UK PE investors into continental Europe. In
order to enhance reliability and comprehensiveness, several complementary sources of data are used. The total sample consists of 754 buyout investments by 69 different UK PE investors that occurred between 1990 and 2005 in continental Europe. For each transaction, data on the investment was collected by CMBOR. Characteristics of buyout investors were primarily found in directories issued by the British Venture Capital Association (BVCA) and the European Venture Capital Association (EVCA).

Variables

The dependent variable in our analysis is binary and indicates whether or not a UK PE investor relies on a local PE partner through cross-border syndication when investing abroad. A value of 1 is attributed if the deal was syndicated and 0 if not. The independent variables measure cultural distance, the legal origin of the host country, bank- versus stock market orientation of the host country, country experience of the PE firm, multinational experience of the PE firm and the human resource base employed at the PE firm. Control variables are added.

Cultural distance is operationalized using the cultural indices developed by Hofstede (1980) and Schwartz (Schwarz, 1999; Schwarz, 2004). With respect to Hofstede’s cultural dimensions, we formed a composite index of cultural distance by calculating the squared terms of the deviation of the cultural index of each country from the UK for each of the four indices (power distance, individualism, uncertainty avoidance and masculinity), then taking the square root of the sum of the four squared deviation terms. Cultural distance on the Schwartz dimensions is computed using country scores from the Schwartz value survey. Schwartz (1999; 2004) describes in detail the construction of these scores. We utilize the 2005 release of the data set for 55 countries surveyed during the years 1988-2004. We constructed measures of cultural distance for the three dimension identified by Schwartz (embeddedness / autonomy, egalitarianism / hierarchy, mastery / harmony). We used the same approach as described above to measure cultural distance.

In order to capture the effect of legal institutions, we use La Porta et al.’s (1998) classification of countries according to legal tradition. A distinction is made between countries in which the legal tradition is based on (1) English common law, (2) French, (3) German, and (4) Scandinavian law. The reference category is the German legal system.

Markets in which owners’ rights are better protected have evolved towards market-based financial systems as opposed to bank-based financial systems (Ergungor, 2004). We measure the importance of stock-based financial markets versus bank-based financial markets by the finance-activity index (Beck, Demirgüç-Kunt, Levine, & Maksimovic, 2000). The finance-activity index equals the log of the ratio of value traded to bank credit. Value traded equals the value of stock transactions as a share of national output. It is frequently used as an indicator of stock market liquidity. Bank credit equals the claims of the banking sector on the private sector as a share of GDP. The higher this measure, the more stock-based is a financial market.

Country experience is measured by the number of previous investments a UK PE firm has in a certain country (Kogut & Singh, 1988). As the marginal effect of this variable on experience is likely to be decreasing, we used the logarithm of this measure. The higher this variable, the more country experience a PE firm has. The multinational experience of a PE firm is measured by counting the number of countries a PE firm has previously invested in (Barkema & Vermeulen, 1998). The higher this variable, the more multinational experience a PE firm has. The human
resource base of a PE firm is measured by the number of investment executives available for following up investments (human resource base PE firm). This measure is divided by the total size of the portfolio in order to control for the size of the firm (Cumming & Johan, 2007).

Several control variables are included in the multivariate analyses. First, we include a measure that captures the size of the PE company namely the total funds managed. Larger firms have access to a more diverse range of resources and, therefore, might be less inclined to syndicate their deals (Brander et al., 2002). We take the logarithm of this measure as this variable is highly skewed. Second, we include a measure that captures the general experience a PE firm has with respect to buyout investing as firms with more investment experience might be less inclined to form a syndicate (Manigart et al., 2006). This variable is calculated by measuring the cumulative number of domestic and foreign buyout investments a PE firm was involved in from 1985 onwards. We take the logarithm of this measure as this variable is highly skewed. Further, because of resource constraints and portfolio risk considerations, it is more likely that larger deals will be syndicated in order to allow for portfolio diversification (Manigart et al., 2006). The size of the deal is measured by the total value of the deal including both debt and equity investments. We take the logarithm of this measure as test statistics show that this variable is highly skewed.

Several control variables are included to account for the heterogeneity observed among buyouts. First, a distinction is made between management buyouts, management buy-ins, a combination of a buy-in and a buyout and investor-led buyouts since there may be different informational asymmetries according to whether the transaction involves insider or outsider management (Wright & Robbie, 1998). The reference category represents management buy-outs. Additionally, dummy variables are introduced to identify the vendor source of the buyout since these too may involve different informational asymmetries (Wright, Robbie, Chiplin & Albrighton, 2000). The following categories are identified: divestments in UK by foreign firms, divestments by UK companies, private & family buyouts, public to private buyouts, secondary buyouts and others such as receiverships and privatizations. The reference category represents private and family buyouts. We also include a measure that captures the importance of stock markets in a certain country as local investors might invite foreign investors in order to have more alternative exit routes (Jääskeläinen & Maula, 2006). This might be especially important when stock markets are not well developed. The importance of stock markets is measured by the total value of IPOs as a percentage of GDP. For each country, we include the average for the years 1996-2000. Further, we include a variable measuring the extent to which the PE market for management buy-outs is developed in a certain country. If local PE investors have no experience with those type of transactions, foreign investors might be less inclined to syndicate their deals (Mäkelä & Maula, 2006a). Therefore, we include a variable measuring the cumulative number of buyouts in a certain country. We take the logarithm of this measure as test statistics show that this variable is highly skewed.

RESULTS

Since the dependent variable is a binary outcome we employ logistic regression to analyze the determinants of cross-border syndication. As investments by the same private equity firm may not be treated as independent, we correct the standard errors by using the clustering option in Stata. This method gives efficient estimates of the coefficients and improved standard errors (Froot, 1989).

The total sample consists of 754 buyout investments by 69 different UK PE firms between 1990 and 2005 in Europe (excluding the UK). The summary statistics for the characteristics of the
PE firms and the buyout deals they are involved in are shown in Table 1. The correlations between all the variables used in the regression analyses are below 0.70 and do not pose serious multicollinearity problems. Given the endogenous nature of legal origin of a country and the finance activity index (Ergungor, 2004), we did not include them into the same regression.

Table 2 presents logistic estimates for the effects of factors influencing the formation of cross-border syndicate partnerships. The dependent variable takes a value of 1 when a transaction is syndicated and 0 otherwise. All the models are highly statistically significant. The p-values reported are two tailed significance tests. Model 1 is a baseline model with the control variables. The more experience a PE firm has with buyout investing, the less likely it will seek cross-border syndication. This effect is marginally significant. The size of the deal has a positive coefficient and is highly significant across all models in line with the financial motive for syndication. Lastly, the higher the percentage of IPO’s as a percentage of GDP, the less likely UK PE investors will seek cross-border syndication.

In model 2, the main effect of cultural distance is introduced. Cultural distance is highly significant and has the expected sign when looking at Hofstede’s measure. When cultural distance is measured using Schwartz’s cultural dimensions, the effect is not significant however. The effect of the control variables remains largely unchanged except for the number of previous buyouts in a specific country. The coefficient of this variable is negative and significant. The effect of IPO’s as a percentage of GDP is no longer significant. In model 3, we introduce different dummies capturing the legal origin of a specific country. The reference category is the German legal system. As predicted by hypothesis 2a, in countries with a legal origin similar to that of the UK, PE firms are less likely to use cross-border syndication. Countries with a French legal origin and a Scandinavian legal origin are more likely to involve cross-border syndication. Model 4 introduces the financial structure variable. The coefficient of this variable is negative and highly significant. The more market-based a financial system is, the less likely a UK firm will rely on local investors in line with hypothesis 2b. Model 5 introduces different PE firm level variables. The effect of country experience is negative as expected and highly significant in line with hypothesis 3. Further, the effect of multinational experience is negative and highly significant providing support for hypothesis 4. The effect of the size of the human resource base at the PE firm is significantly negative in line with hypothesis 5. Lastly, in model 5 we introduce all the variables simultaneously except financial structure activity in order to test the robustness of our model. The effect of cultural distance as measured by Hofstede’s cultural dimensions is no longer significant. Surprisingly, the effect of cultural distance as measured by Schwartz becomes significant and has the expected positive sign. Hypothesis 1, therefore, receives some support. Except for the positive effect of the French legal system, the other significant effects of country legal origin disappear providing weak support for hypothesis 2. This is not surprising as the French legal system is considered to offer the lowest legal protection for investors. The effects of PE firm level variables remain unchanged providing support for hypotheses 3, 4 and 5. In model 6, we include all the variables except the legal country origin dummies. The cultural distance measures have the expected sign but are not significant. The financial structure measure has the expected sign and is highly significant providing support for hypothesis 2b. The learning variables – country experience, multinational experience and human resource base – have the expected sign and are significant providing strong support for hypotheses 3, 4 and 5.

**DISCUSSION AND CONCLUSION**

In this study, we sought to extend previous research by studying the internationalization process of private equity firms. More specifically, using insights from institutional theory, we
analyzed the impact of cultural and legal context on the need to rely on local private equity firms through cross-border syndication. Further, using insights from learning theory, we studied whether international and multinational experience reduce cultural and legal barriers thereby lowering the need to rely on local partners through cross-border syndication. Moreover, we looked at the impact of the human resource base on the speed of learning. Our hypotheses were tested by studying the international expansion of UK PE firms specializing in buyout investments into continental Europe during the period 1990 to 2005. Data for this study were drawn from a unique, hand collected dataset maintained by the Center for Management Buy-out Research (CMBOR).

The empirical results provide weak support for the view that cultural differences induce private equity firms to rely on local partners through cross-border syndication. In contrast, we found strong support for the proposition that regulatory differences affect cross-border private equity syndication decisions. The weaker the legal system – as measured by the origin of the legal system and the stock-market orientation of the financial markets – the more likely private equity firms rely on local investors in order to deal with the peculiarities of the legal environment. In line with the staged approach to foreign entry mode (Johanson & Vahlne, 1977), our results indicate that PE firms reduce cultural and legal barriers through learning. Using insights from learning theory (Cohen & Levinthal, 1990), our results provide strong support for the view that country level experience and multinational experience reduce the need to rely on local partners through cross-border syndication. Further, the larger the human resource base at the PE firm, the faster PE firms learn and hence the lower the proclivity to use cross-border syndication.

Our findings make a number of contributions to the literature. First, we contribute to the literature on PE, and especially that relating to the later stage PE market, which has neglected the issue of cross-border syndication. Most of the PE literature has focused on the early stage venture capital market. In many countries, however, the later stage management buy-out market accounts for the vast bulk of PE activity. Even though there is some considerable degree of overlap between specialist providers of funds to buyouts and VC firms, there are some major differences (Wright & Robbie, 1998). As such we help to extend the literature on later stage PE investing. In the context of private equity investing, this study is the first to examine determinants of cross-border syndication on a large scale sample. Whereas previous literature (Mäkelä & Maula, 2006a; Mäkelä & Maula, 2006b) has mainly used case studies to derive insights on cross-border syndicates, our study helps to validate some of these insights on a representative sample of PE firms. Further, learning theory has been used to explain the performance of VC firms (De Clercq & Dimov, 2007). This study shows that learning theory is a useful framework to explain the internationalization process of PE firms.

Second, we contribute to the international business literature in terms of generating further understanding of the heterogeneity of the service sector (Buckley et al., 1992; Miller & Parkhe, 1998). PE firms invest in a foreign venture not with the purpose of managerially controlling it – as in the case of conventional manufacturing or service firms – but with the aim of making a financial return when they divest. At the same time, PE firms assume an active role by monitoring and adding value to their portfolio companies. Thus, the question whether PE firms rely on local partners through syndication is a novel and distinct phenomenon when compared to the more conventional foreign investments undertaken by either manufacturing or service firms.

For practitioners, our findings provide insights into the complementarities involved in syndication and recruitment strategies when PE firms internationalize. PE firms that internationalize may explicitly pursue an initial strategy of syndicating with local partners since expertise gained in the domestic market may not easily transfer to a foreign context. Once they
have built experience, they may gradually rely more on investing on their own. Our results also show that, rather than being constrained to recruit executives with PE experience in a particular country or particular institutional environment into which they are entering, PE firms can usefully transfer executives who have multinational experience from elsewhere. Further, our findings indicate that cultural barriers seem to be less important for later stage private equity investments; private equity firms could enter foreign markets by investing in later-stage companies in order to gain experience about the local environment. As private equity firms gain experience about the local environment, they might gradually increase their involvement in earlier stage investments.

There are a number of limitations associated with this study that suggest avenues for future research. First, we have taken the perspective of the foreign investor in order to examine cross-border syndication decisions. It is clear that foreign investors might be invited by local investors for their expertise or their reputational capital (Mäkelä & Maula, 2006a). As such, having an experienced, foreign investor might provide an important learning opportunity for the local investor. Cross-border syndicates, therefore, might be driven by the desire of local investors to learn from more experienced foreign investors rather than the desire of the foreign investor to learn about the local environment. Future research could explore cross-border syndicates taking both perspectives into account. Second, we did not have data on the nationality of the private equity executives or the national presence of PE investors in a certain country at the time of each focal deal. Internationally active PE firms often employ executives with a background from the host country. As such, their need to rely on local partners to deal with cultural and legal barriers will be reduced. Additionally, some of the larger PE firms have local branches in foreign countries. Not controlling for this could potentially affect the results. While at least some of these data may be available from current websites, there are problems in collecting such data retrospectively over the period of time covered here. Future research could usefully examine how PE firms use a mix of strategies – attracting local PE partners, working with local PE firms or setting up local branches – in order to deal with the peculiarities of the local environment.

CONTACT: Miguel Meuleman; miguel.meuleman@vlerick.be; (T): 0032(0)92109770; (F): 0032(0)92109790; Vlerick Leuven Gent Management School, Reep 1, 9000 Gent, Belgium.

REFERENCES


Table 1: Sample Description

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Control variables

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<th>Std. Dev.</th>
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Table 2: Logistical Regression Using Robust Standard Errors (N=754)

Dependent variable equals 1 if investment is syndicated, 0 otherwise

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† p<0.10, *p<0.05, **p<0.01, ***p<0.001