THE ROLE OF NETWORK TIES IN MITIGATING ASYMMETRIC INFORMATION IN CROSS-BORDER VENTURE CAPITAL EXITS (SUMMARY)

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SUMMARY

THE ROLE OF NETWORK TIES IN MITIGATING ASYMMETRIC INFORMATION IN CROSS-BORDER VENTURE CAPITAL EXITS

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Principal Topic

We introduce an extension to the current theory of incomplete and asymmetric information by presenting an argument for the role of contacts of the market participants in mitigating the informational asymmetries in transactions of ownerships of entrepreneurial firms. On one hand, direct contacts to the markets offer credible certification for the quality of the venture. On the other hand, the broader the reach of the indirect contacts of the actor, the higher the diffusion of information among the potential investors, and the higher the increase in the investor recognition.

To test our theoretical arguments we formulate a set of hypotheses concerning the impact of direct and indirect foreign VC ties on the selection of exit market and exit mode. We hypothesize that the role of direct ties (foreign VCs) in providing certification is emphasized in IPOs, while the indirect ties (the contacts of domestic VCs to foreign VCs) create both diversity and reach that enhance the diffusion of information, thus enabling the identification of potential investors for trade sale exits.

Method

We test the hypotheses in the context of the arrangement of venture capital exits to foreign markets. Using SDC VentureXpert, Global Issues and International M&As databases we observed the financing rounds, investors, nationalities, and exits for a sample of 1431 European VC funded companies, which received their first financing round between the years 1984-1998. Outcomes for the ventures were observed at the end of 2004.

Results and Implications

As predicted, we found direct and indirect ties to have a differential impact on exit modes. Direct foreign VC ties are critical for foreign IPOs while indirect ties facilitate both foreign acquisition and foreign IPOs. Our results confirm the certification effect of venture capitalist in the context of cross-border venture capital exits and add to the literature by highlighting the greater effect locally embedded investor. More interestingly, in the case of M&As, the ties between the financial intermediates facilitate the information distribution and search of buyers. This contributes to the theoretical literature on asymmetric information by creating understanding on the role of contacts in distributing information on investment targets and alleviating the informational problems in financial markets.

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