

# **DIFFERENT ROLES OF VENTURE CAPITALISTS BETWEEN KOREA AND THE US: A SURVEY**

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## **ABSTRACT**

Collecting and analyzing the survey data from US and Korean venture capitalists, we find that the roles of venture capitalists of both countries are markedly different especially in growth assistance and argue that the strong performance of US venture capital industry is due to the extensiveness in its growth assistance role. This paper emphasizes that it is not the funding itself but the growth assistance role of venture capitalists especially in strategic networking, recruiting, consulting and monitoring that makes the venture capital business successful.

## **INTRODUCTION**

Generally US venture capital funds did and are expected to generate 15 to 20% returns over the life of the fund, which surely outperforms the public markets. Although neither are performances of funds reported to the public nor calculated by any institutions in Korea, the six year average of return on equity (ROE) of venture capital firms between 1989 and 1995 was 2.4%, according to the ministry of commerce and industry in Korea. Can we explain why the performances of venture capitalists of the two countries are so different? As Zider [7] claims, is the strong performance of US venture capital industry due to the extensive control and oversight of the firm where they invest? Using the survey data from US and Korean venture capitalists, we find that the roles of venture capitalists of both countries are markedly different especially in growth assistance and argue that the strong performance of US venture capital industry is due to the extensiveness in its growth assistance role.

Lerner [5] finds that old and experienced venture capital firms show better performance than younger venture capital firms because the old ones bring their portfolio companies to IPO markets timely when there occurs less underpricing. According to Gompers [3], young venture capital firms show poorer performance because of “grandstanding” phenomena that young venture capital firms bring their portfolio firms public earlier than older venture capital firms to establish a reputation and successfully raise capital for new funds. Their arguments may be true for US venture capital industry since old venture capital firms show better performance relatively in the US. However, if we look at Korean venture capital industry, old venture capital firms do not show better performance than young ones. Their arguments based on the IPO assistance role of venture capitalists should hold for Korean venture capital firms as well because Korean venture capital firms have the same incentive to bring their portfolio companies timely to IPO markets as those of the US. We claim that the performance of venture capital firms depends on the growth assistance role, not on the IPO assistance role of venture capitalists.

## **SURVEY ANALYSIS**

### **Stages of portfolio companies**

The survey shows: First, US venture capitalists invest most in early stage (more risky) of portfolio companies whereas Korean venture capitalists invest most in expansion stage (less risky) of portfolio companies. Korean venture capitalists also think that their role is most important at the early stage of portfolio companies, but actual investing is more in expansion stage of portfolio companies. Second, most US venture capitalists make follow-on investments after first investment (so-called staged financing) but a few Korean venture capitalists do. The staged financing is an essential strategy for venture capitalists to control and assist portfolio companies. Third, US venture capitalists form syndication for risk sharing but Korean venture capitalists need syndication to accommodate the size of investment. All the results imply that US venture capitalists are more interested in helping and monitoring roles to maximize their return while controlling risk whereas Koreans are interested only in quicker results without performing their adequate roles as venture capitalists.

### **Roles of venture capitalists**

When the role of growth assistance is divided into consulting, monitoring, strategic networking, and recruiting, US venture capitalists indicate strategic networking as the most important followed by the order of recruiting, consulting, and monitoring with virtually equal importance. However, Korean venture capitalists indicate consulting as the most important followed by strategic networking, monitoring, and recruiting. Strategic networking and recruiting are considered as much more important for growth assistance in the US than in Korea. This means that most Korean venture capitalists have only vague idea of consulting when it comes to helping portfolio companies compared to US venture capitalists who has the more specific idea of assisting portfolio companies like strategic networking and recruiting. This finding is also related to the fact that Korean venture capitalists focus more on fund assistance than growth assistance.

We also find that the most wanted consulting service by portfolio companies in the US is marketing consulting whereas financial/accounting consulting in Korea. The finding that financial/accounting consulting which is relatively minor in importance in the US is the most important in Korea confirms that Korean venture capitalists view themselves as financial supporters or investors. As a monitoring method, US venture capitalists use most widely the monitoring by the participation in the meeting of board of directors, which is used very rarely by Korean venture capitalists. Korean venture capitalists use rather the monitoring method of interview with CEOs. On average, the number of portfolio companies each venture capitalist is responsible for follow-up is 5.9 in the US and 10.4 in Korea so that substantial monitoring is less possible for Korean venture capitalists. Also, in the US, most of the venture capitalists participate as a director in the board of directors' meeting of portfolio companies. On average, each venture capitalist serves on 4.8 portfolio companies' board meetings as a director. In Korea, slightly more than half of the venture capitalists participate as a director in the board of directors' meeting of portfolio companies. On average, each venture capitalist serves on 2.7 portfolio companies' board meetings as a director.

Lastly, we find that venture capitalists spend most of their time on the evaluation of investments in both countries, but only US venture capitalists spend on average 45.8% of their time on monitoring as well. It is interesting to note that older venture capital firms rather than younger ones prefer portfolio companies at later stage when they invest in both countries. Contrary to the earlier claims (Bygrave [1] [2], Gupta and

Sapienza [4], and Norton and Tinnenbaum [6]), whether or not venture capitalists have preferences in investment areas has nothing to do with the stage of portfolio companies when they invest in both countries. And when they provide portfolio companies with funding, Korean venture capitalists are more concerned about supplying operational funding to portfolio companies while US venture capitalists are more concerned about helping portfolio companies especially in R&D and marketing.

This paper emphasizes that it is not the funding itself but the growth assistance role of venture capitalists especially in strategic networking, recruiting, consulting and monitoring that makes the venture capital business successful.

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