

Why investors plant seed money in certain soil

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Seeding funding depends on how well the country in question deals with protection of property rights, deal flow and corruption.

Just as spring rain germinates grass, private equity germinates new companies. And investors in Venture Capital and Private Equity Limited Partnerships till the soil in both emerging and advanced nations when deciding where to plant their seed money. In this globalized world, institutional investors must pick and choose from among a variety of entrepreneurs standing on fertile ground in many countries.

The paper "[International Allocation Determinants of Institutional Investments in Venture Capital and Private Equity Limited Partnerships](#)" by Alexander P. Groh, Heinrich Liechtenstein and Miguel A. Canela studies and presents investor criteria for allocating funds internationally. Protection of property rights ranks first, followed by expected deal flow and concern over bribery and corruption.

There are significant differences in Venture Capital and Private Equity markets across nations. On national levels, VC/PE activity is often measured as a percentage of GDP. Using this ratio, the United Kingdom currently leads the worldwide ranking, followed by the United States. These countries think alike on investment-related issues, and share common law systems and entrepreneurial and capital market-oriented economies.

Yet, not all nations are on the same level; and many emerging economies offer attractive opportunities for investment. To determine the variables that inspire investors to allocate risk capital in an economic region, the researchers sent out a questionnaire to more than 1,000

institutional investors in VC/PE Limited Partnerships. They probed six criteria: economic activity, capital market, taxation, property rights protection, social environment and entrepreneurial activity.

Protect my property.

By far, the most important issue for investors when evaluating an economy is the protection of property rights. Whether referring to intellectual property, real property (real estate or land) or personal property, investors want assurance that they have sound legal rights. Corporations, like individuals, should have the right to use their property in the manner in which they see fit, or to dispense with it or transfer ownership.

Good people. The second most important issue for institutional investors is the ability to find quality local fund management teams, or general partners. They need to feel confident about the quality and skills of the local entrepreneurial managers. Talented people matter. If investors feel that that can rely on people as the driving force behind the VC/PE business and the target companies, they are more likely to commit capital.

Let the deal flow. Expected deal flow comes next on their list of priorities. Investors want the deal to roll along and there are many factors, pertaining to socio-economics and the market, at work. For instance, deal flow is influenced by economic growth and size and by the presence of supporting institutions, such as investment banks and M&A boutiques, among others.

Stop corruption. Finally, and coinciding with their desire for protection, investors fear bribery and corruption, since they directly interfere with the enforcement of their claims.

Public funds don't attract private ones. Another important finding is that institutional investors do not at all consider the availability of public subsidies when making their allocation decisions. Public money will not attract private money. This questions the existence of government programs intended to spur the market for risk capital. Additionally, the role of the public stock market and the IPO market is not as relevant as expected.

In sum, the paper appeals for more transparency of the international capital allocation process of institutional investors. It also serves as a guideline for policymakers attempting to attract more risk capital for their countries to spur innovation, entrepreneurship, growth and employment.

Entrepreneurs need more than just a bright idea and a garage. They need seed money, and

by protecting investors' property rights, making sure deals flow and eliminating bribery and corruption, policymakers can make their nation's soil more fertile ground for investing.

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