Lecture Text

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International Entrepreneurial Finance

(*edited for clarity*)

Introduction
Welcome, everybody, and thank you for coming this morning. What I'd like to do today is provide you with some insight into the world of international entrepreneurial finance (IEF). This is essentially a field research project that has occupied me over the last five years.

In terms of structure of what I want to do today, I'd first like to talk to you about the central research question of this field research project. I'll then give you an overview of some of the characteristics of the field research project. Then I have a fun part, where I'll actually share with you some of the field research sites, and these are some colorful pictures. I have nine of these that I selected. Then we get to the central course ideas, and in addition to stating these course ideas, I'll seek to tie them to existing research.

Core Question and Research Characteristics
Now, to get started, the core question of the field research project is how do entrepreneurial managers and those who finance them make resource acquisition and investment decisions in an international context? With the rise of entrepreneurship around the globe over the last fifteen years, this is a very salient research question. Also, it's important because this field research project complements a large body of literature on international business that was primarily focused on established multinational firms, a body of literature on international finance, and an emerging body of literature on entrepreneurship.

What are the characteristics of this research program? First of all you can think of this as a deep dive into the practice of international entrepreneurial finance. So I've really been exposed to this phenomenon in great detail and I've learned from this in a way I don't think I could have learned in any other way than actually looking at a large number of field research sites.

Altogether there are twenty-nine field research sites in this sample. They cover over twenty countries and they cover variants of situations from start-ups to some entrepreneurial buy-outs with a focus on entrepreneurial start-ups. Again, as I said, many country contexts—over twenty—technologically intensive settings, technologically intensive industries, as well as seemingly low-tech industries. And then there is also variance in terms of the deal structures and business models in here.

In addition, I think it's important to point out that the purpose of this field research project was both to generate and to test hypotheses. Some of the hypotheses that have been generated by this project will have to be tested with larger data sets later. As a matter of fact, I'm in the process of doing that now with one research question that emerged from this field research project. But quite a few of the hypotheses that we're generating could also be tested with this sample of twenty-nine. In fact, two of my recent papers have been based on this sample.

Finally, I think it's important to point out that this field research is both comparative in nature, in the sense that it looks at entrepreneurship in different country contexts and—this is very important—it's cross-border, because an increasing number of entrepreneurial firms go abroad much earlier in their lives than ever before in recent business history.

A Sample of the Research Sites
So let me get to the fun part first, before we actually focus on the central ideas. These are fourteen out of the twenty-nine field research sites. As you can see, they range from very high-tech things like CD metallization equipment to very seemingly low-tech things like pizza delivery. They cover, as I mentioned, a wide range of industries, and what's also interesting here is that there is variance in performance. They range from spectacular successes, for example, Infosys, an Indian software company, where essentially poor entrepreneurs became billionaires over a period of twenty years and, incidentally, they still are billionaires, in comparison to some people who became billionaires for a very, very short period of time and are not anymore.

Also, there are cases about outright failures. For example, TixToGo, a Silicon Valley start-up with some international aspiration, was an outright failure. And there are mediocre successes. And this variance in performance allows me to gain insights into what drives the performance of these firms.

Singulus
OK. Here's the fun part. Not that you recognize this, but this is a CD metallization machine. The entrepreneur who started Singulus, which was a newly created company based on an existing technology, at the time he did this he was fifty-three years old. He was a senior manager in a German company, had three kids in university, and this was a path of no return. If he was not successful with this, there was no way he was going to get back his old job or a similar job and the standing that came with this job.

The company was successful, and I guess it was partially successful because this person was driven very hard since he knew that this was it, or nothing. He created a fortune of about $40 million for himself, but more importantly, he established a 60 percent world market share. If you bought a CD in the last five years, there is a chance of more than 50 percent that it was metallized by one of these machines. Metallization is putting this thin layer of metal on the CDs before the actual information is put on them.

Officenet
Next, Officenet. This is an Argentinean start-up for office supply distribution. It's essentially a little bit like Staples without stores. Now in order to understand this company that was started in 1997, you need to know something about the context in Argentina. At the time that this company was started, office supply distribution was extremely fragmented. Also, the postal system in Argentina was notoriously unreliable, so you couldn't just ship things with a reliable logistics company.

The entrepreneurs who started this company basically first developed a catalog. And this was not trivial. So this catalog was the first kind of catalog in a long time that existed in Argentina because there are no mail-order stores, and they organized a distribution system that was efficient and outsourced in the Buenos Aires region. This is the only region they focused on at that point because the population density was high enough, and the company actually did quite well, and is still doing quite well despite Argentina's economic troubles. The company, incidentally, has successfully expanded into Brazil and its expansion into Brazil has buffered some of the recent problems that Argentina faced macroeconomically.

Ducati
OK, this is a motorcycle. Ducati, a well-known brand. This is one of the entrepreneurial buy-out cases and field research sites that I examined. Ducati is a brand with a long standing. But the entrepreneurs who took over ownership from the family that essentially had mismanaged this company took considerable risks. The field research sites exemplify how difficult it is and how important it is to strike the right deal structures in complex settings like Italian family ownership. At the time that this transaction happened, the company was not delivering any motorcycles anymore. Work in progress had mushroomed because certain parts were missing for motorcycles and they essentially couldn't pay their suppliers for these.

Georgian Glass & Mineral Water
Now I don't expect you to be able to read this. Is there anybody here who can read Russian? Anyway, I can tell you what it's about. This is part of an advertising campaign to make people in Moscow and St. Petersburg aware of counterfeited Borjomi water. Borjomi is the most famous mineral water brand in the former Soviet Union. It has a brand recognition, or had at the time that this company was created in 1995, that was higher than Coke. Somebody once described it to me as "water that tastes like rotten eggs," because of it's high sulfur content. But because the water has almost medicinal qualities and cures everything from hangovers to other ailments, it's very popular in countries of the former Soviet Union.

The entrepreneurs were faced with extremely weak property rights in Georgia. It's sometimes helpful at the beginning of talking about this case to explain that this is Georgia the country, as opposed to Georgia the state, depending on the audience I'm talking to. There was actually so-called "leakage" of water as it was being shipped in railcars from Georgia to Moscow or St. Petersburg. Only 95 percent or so of the water arrived.

In addition, a large percentage of water was bottled in Moscow and St. Petersburg bathtubs into used bottles. You can imagine the health risks this creates. And the Georgian Glass and Mineral Water case exemplifies how a company can be successful in dealing with these weak property rights. I'll say a bit more about this later.

Spotfire
This is Spotfire. Spotfire is a Swedish company that develops and produces software for the analysis of complex data sets. Spotfire was started in Sweden under extremely unfavorable terms for the entrepreneur. The company, because it developed its products quite well, succeeded in eventually attracting venture capital from a transatlantic venture capital firm, Atlas, that operates both in the United States and in Europe. With Atlas's help, Spotfire made the decision to transfer all of its operations—headquarters, marketing, everything except for research and development—to the United States. So at the tender age of eighteen months or sixteen months, we had a small multinational with R&D in Sweden in Gothenburg and all the rest operating here in the United States. This creates enormous challenges for a company that, at that point, had a head count of fifty-five people. And the field research sites exemplify some of these issues. Also it exemplifies the motives of international expansion, but also some of the issues in coordinating internationally.

Mobile Communications Tokyo
This is something that's in most of your cell phones. It's a module that provides code division multiple access, CDMA module, and it enables your cell phone to use the airwaves more efficiently. The company, Mobile Communications Tokyo, is a true start-up in Japan, and you have look for these start-ups with a magnifying glass, because there are not that many of them. So it took me quite a while to find something that I really thought

exemplified entrepreneurship from the start, by a Japanese entrepreneur in a Japanese setting.

The company designs and manufactures these chips in small and large batches and, as I'll show later, the company faced serious trouble in raising financing. Initially it was internally financed, but then it faced trouble raising more financing. I'll talk about this some more in a few minutes.

Jinwoong

This is Jinwoong, the world's largest manufacturer of camping tents and outdoor gear. Their largest customers include Wal-Mart, Kmart, and Target. They have a 60 percent market share in the United States. The company is Korean. It was started in Korea and grew through clever designs of tents, and hard work, to an amazing multinational company. What is interesting is that the company moved its manufacturing base, first out of Korea into lower-cost locations in the Dominican Republic and in Bangladesh, and eventually to China.

However, the company kept financing itself, just like any good Korean company would finance itself, with lots of debt from Korean banks. The financial crisis in Asia of '97 and '98 almost broke the company's neck. Even though the product market strategy worked very well, and Wal-Mart and Kmart were the largest customers, and happy to pay, the company couldn't receive its payment from the central bank in Korea.

Jinwoong exemplifies what can happen if an entrepreneur doesn't have a global perspective on access to resources, and it also exemplifies what an entrepreneur can do to rescue a company if such an exogenous shock occurs.

Gray Security

This is Gray Security. Gray Security is the largest building security firm in South Africa. They provide unarmed guards for commercial property. Ever since studying these field research sites, I've started looking at the guards at the entrance of our parking lot in a different way, both in terms of the economic model but also in terms of what I know about how trained these people are, or how trained they are not, and how high their turnover is. In the industry, typically, the turnover is about 200 percent per year.

Coming back to Gray Security here. The entrepreneur created this company from scratch with no external financing and grew it just out of cash flow to a size of $100 million in revenue, and made a fortune for himself and his co-founders. But also, and this is the interesting aspect of this case, Gray Security exemplifies how an entrepreneur can react to and benefit from an exogenous shock—in this case, the end of apartheid in South Africa. The company was started before the end of the apartheid regime. Never cooperated with it, never had government contracts, but really started thriving afterwards and expanded into other African countries from there.

TCS

This here is Pakistan's largest airfreight company. It's the equivalent of Federal Express in Pakistan. How many planes do you see in this airfreight company? Two, right? They actually have three. For some reason the third one didn't make it into the picture. But you see hundreds of motorcycles and some delivery trucks. The founder of this company initially worked for a DHL joint venture that just did international transport in and out of Pakistan and then spotted this opportunity. Fought a long battle with the postal service as to what degree the monopoly on shipping letters applied to business shipments, and finally succeeded in getting an exemption for that, although that exemption was continuously contested by the postal service.

He, for several years, was the largest single identifiable taxpayer in Pakistan, and thus was a natural target for extortion. The field research actually revealed a very striking example of an extortion attempt where somebody tried to sell him a plane without proper documentation, and when he refused to take this plane, his company was shut down for a few weeks. Talk about weak property rights!

What the case and the field research here exemplifies is how an entrepreneur can secure the fruits of his or her labor through international expansion and also ensure his or her personal security by making some moves—in this case, an expansion in the UAE and an expansion into Canada, geographic expansion.

TelePizza
And, finally, TelePizza. An interesting field research site. TelePizza is a pizza delivery company that was started by a former Johnson & Johnson executive, originally Cuban, U.S. national, who went over to Spain for Johnson & Johnson and started this pizza delivery company. The company really benefited from changing demographics in Spain, with more working mothers, and the entrepreneur was successful in positioning pizza as a home food. So pizza here is not about grease, starvation, and student life. Pizza is about home food, and in most cases TelePizza orders get triggered by children who ask their parents to order this for them. So the entrepreneur was actually not so well liked by many Spanish parents, who would ask him, "What did you do to my children?"

But, he created—and this is another amazing example of financing—out of an equity investment of $100,000 and no further equity investment, through franchising, a value of $300 million in cash when he sold his company twelve years later.

Pizza is something that you and I could produce. The devil here is in the details of the execution of organizing orders.

Entrepreneurial Activity by Country
Let me finish this first fun part with some data before then getting to the central ideas of the field research project. This is a chart that shows opportunity-based entrepreneurial activity by country. And it's from a source called the Global Entrepreneurship Monitor. What was basically done for this was, surveys were conducted in many different countries, and what you see on the Y-axis here is the percentage of adults between eighteen and sixty-four who either started a company in the previous four years or were in the process of starting one. There are actually some issues with the data collection, but I'm fairly confident that in tendency they are correct. I have some questions about some of the details. But still, this is an interesting puzzle. Why is there such a variance in entrepreneurial activity? What drives this, and to what degree can entrepreneurs in different countries, when they think about starting a company, benefit from knowing about this variance in entrepreneurial activity?

QUESTION: What is "opportunity-based"?

PROFESSOR KUEMMERLE: Good question. The survey distinguished between opportunity-based and need-based entrepreneurship, essentially defining opportunity-based entrepreneurship as entrepreneurship that did not occur to avoid unemployment or to escape from poverty. So opportunity-based entrepreneurs are entrepreneurs who would have other opportunities. Any Harvard Business School graduate who starts a company would fall into the category of opportunity-based entrepreneurship. At least that's what one would hope, even in a tough job market.

Now this is a phone survey of all these countries, and it was conducted by different people in different research companies in different countries. So there are some issues about comparability, but in tendency the researchers who conducted the survey sought to distinguish between opportunity-based and need-based.

QUESTION: Why did it matter?

PROFESSOR KUEMMERLE: The rationale of the researchers, I think, was that opportunity-based entrepreneurship would make a stronger contribution in general to technological progress of a country, while need-based entrepreneurship was simply an indicator to what degree there was flexibility in the system to allow people who couldn't do anything else to at least start a small business. So a street vendor would be in the need-based entrepreneurship category, if the person couldn't do anything else, which is true for many African countries, for example, where there is very little opportunity-based entrepreneurship.

Three Central Ideas

So there are three central ideas that have so far resulted from IEF. The first one is that the local context actually matters for the frequency and form of entrepreneurial activity. The second idea is that a global perspective on opportunities by the entrepreneur enhances the performance of entrepreneurial ventures. And the third one is that a global perspective on access to resources enhances the quality of deal structures for entrepreneurial ventures and, thus, the likelihood of venture survival, particularly in tough times when cash is tight.

In summary, or taken comprehensively, the argument here is that, if you want to be successful as an entrepreneur it is important to both have a detailed understanding of the local context, but also to have a perspective on opportunities and resources globally.

Let me get into this in more detail.

Local Context Matters

And let me start with the local context. What is it we know about research on the local context? And it actually turns out that we know quite a bit. First of all, we know that local institutions matter. If you look at the law and finance literature, La Porta, Lopez-de-Silanes Shleifer, and Vishny[1] have done a lot of work here; Luigi Zingales[2] has done some work on it. The argument here, or what they have found, is that the legal origins, common law or civil law, with civil law being distinguished into even more fine-grained categories, matters for the quality of financial markets that exist.

If you look at some recent work by Acemoglu and Johnson[3] on colonization policies in Africa, they have found that institutions matter and persist even long after colonization has ended and these countries have achieved independence. Incidentally, Johnson[4] and others have also found, in a study of certain transition countries in eastern Europe—I think five of them, this is an *AER* piece in 2002 I think—that what really matters for entrepreneurs, to reinvest profits from ongoing companies, is property rights, rather than a liquid financial system.

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[1] La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny. 1998. Law and Finance. *Journal of Political Economy* 106 (6):1113-55.
[2] Guiso, Luigi, Paola Spapienza, and Luigi Zingales. 2001. The Real Effects of Financial Development (Working Paper). Chicago: University of Chicago.
[3] Acemoglu, Daron, Simon Johnson, and James A. Robinson. 2001. Colonial Origins of Comparative Economic Development. *American Economic Review* 91 (5):1369-1401.
[4] Johnson, Simon, John McMillan, and Christopher Woodruff. 2002. Property Rights and Finance. *American Economic Review* (5):1335-1356.

Property rights seem to be more important, and without property rights entrepreneurs will not reinvest.

In addition, there is work on this second point here about the definition of success, and it varies across countries. If you go back to Hofstede[5], who looked at one multinational company, he found variance on several dimensions in this multinational company, to the degree that it was a male-dominated culture or it was a female-dominated culture, to what degree a culture and a nation—because they looked at nations—was able to tolerate different power relationships. To what degree would a nation avoid uncertainty? These were factors that Hofstede identified.

If you look at some more recent work by DiTella and others,[6] Rafael DiTella here at the school, on happiness, they found that entrepreneurs in the United States. are actually happier than entrepreneurs in Europe. So there are clear differences as to what brings about happiness for people.

Another stream of literature has looked at entrepreneurial ecosystems. This is AnnaLee Saxenian[7], who looked at Silicon Valley and Route 128, and that stream of literature essentially argues that entrepreneurial ecosystems are very complex and multidimensional, and actually, understanding these systems is complex enough, but replicating them is even more difficult.

And, finally, a stream of work that's important for this is work on financial institutions and contracts. If you look at Bill's [Sahlman] work[8] and Paul Gompers'[9] work and Josh Lerner's[10] work on venture capital in the United States, we know that certain contract elements, covenants, syndication, staged financing, matter for the venture capital system and for entrepreneurial activity in a country.

Now there are some open questions, if you look at countries across the world. First of all, there is this question, which aspects of the local context matter most? And then there is a question regarding patterns of entrepreneurial success in contexts that are quite adverse to entrepreneurship. What does it mean if you're successful? What can we learn from that? And to what degree does this position an entrepreneurial firm uniquely?

What have I found in looking at these field research sites? First of all, I do find that the local context is an important determinant of the frequency and form of entrepreneurship that occurs. Second, I do find that there are differences regarding the definition of success. For example, if you look at a country like Japan or a country like China, it seems that monetary aspects of entrepreneurship alone are less important than in the United States, and that social standing, at least during a certain period of the growth of this entrepreneurial venture, plays a considerable role.

It is important to note that successful entrepreneurial managers seem to analyze multiple dimensions of the local context. So this is not just economic context, it's also about

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[5] Hofstede, Geert H. 1980. *Culture's Consequences: International Differences in Work-Related Values.* Beverly Hills, CA: Sage Publications.
[6] DiTella, Rafael, Robert J. MacCulloch, and Andrew J. Oswald. 2003. The Macroeconomics of Happiness. *Review of Economics and Statistics* (forthcoming).
[7] Saxenian, A. 1994. *Regional Advantage—Culture and Competition in Silicon Valley and Route 128*. Cambridge, MA: Harvard University Press.
[8] Sahlman, William A. 1990. The Structure and Governance of Venture Capital Organizations*. Journal of Financial Economics* 27:473-521.
[9] Gompers, P. A. 1996. The Use of Covenants: An Empirical Analysis of Venture Partnership Agreements. *Journal of Law and Economics* 39:463-498.
[10] Lerner, J. 1994. The Syndication of Venture Capital Investments. *Financial Management* 23 (Autumn):16-27.

understanding the political institutions and the social norms that apply in that specific country, and there is variance in these, just as there is in entrepreneurial activity.

And finally, if you look at firms that succeed, such as Officenet, despite enormous contextual obstacles, that puts these companies in a unique position, for an eventual trade sale to a multinational company. By the way, if an entrepreneur from the very beginning decides to run an ethical company, in an environment where corruption is a notorious problem—take Nigeria or Pakistan—that gives this company a very unique position and creates considerable barriers to entry for others that follow.

So that's actually encouraging for some of the aspiring entrepreneurs who might have to make a trade-off: Should I start in an industrialized country or in an emerging markets country? If, in fact, the entrepreneur thinks that he or she can achieve such a position, this might be a very attractive opportunity to pursue, even though the context, as such, is adverse.

Global Perspective Enhances Venture Performance
The second central idea is that a global perspective on opportunities will enhance the performance of entrepreneurial ventures. Let me first focus on the existing research here. There is a large body of literature in international business that focuses on international expansion of established firms. Ray Vernon[11], with his product life cycle theory, has essentially argued that what you will observe generally is that firms first manufacture at home and export. Eventually they'll manufacture locally and sell locally. Then they'll manufacture locally and sell back to the home country, and eventually manufacture everywhere, or at certain locations, and sell broadly—in an optimal system.

Essentially what firms do when they follow this path is they exploit their home base by using capabilities at their home base best elsewhere. In earlier work, others and I have argued that there is an alternative motive for foreign direct investment, which I call "home-base augmenting"[12]: firms going abroad in order to acquire new capabilities from local environments or clusters that they could not acquire otherwise; they couldn't acquire simply through licensing in as an alternative, for example.

It is interesting to ask whether these two motives apply to start-ups or entrepreneurial firms in general as well. In the entrepreneurship literature—to shift to a third stream of work that's relevant for thinking about opportunities in a global context—there is work on overconfidence bias. Both the theoretical literature—Ivo Welch[13] and others in the *Journal of Economics and Management* have argued about that, and then there was a piece by Cooper[14] and others in 1988 in the *Journal of Business Venturing* that surveyed 4,000 entrepreneurs, and 81 percent of them perceived odds of seven out of ten or better for their entrepreneurial venture. It seems to be very persistent, this overconfidence bias.

Finally, global start-ups are an emerging phenomenon. They first were documented around 1993 and 1996 by Rennie[15] and McDougall[16]. And these are essentially firms that very early

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[11] Vernon, R. 1979. The Product Cycle Hypothesis in a New International Environment. *Oxford Bulletin of Economics and Statistics* 41 (4):255-267.
[12] Kuemmerle, Walter. 1999. The Drivers of Foreign Direct Investment into Research and Development. *Journal of International Business Studies* 30 (1):1-24.
[13] Bernardo, Antonio, and Ivo Welch. 2001. On the Evolution of Overconfidence and Entrepreneurs. *Journal of Economics & Management Strategy* 10 (3):301-330.
[14] Cooper, Arnold C. , Carolyn Y. Woo, and William C. Dunkelberg. 1988. Entrepreneurs' Perceived Chances of Success. *Journal of Business Venturing* 3:97-108.
[15] Rennie, Michael W. 1993. Born Global. *McKinsey Quarterly* (4):45-52.
[16] McDougall, Patricia P., and Benjamin M. Oviatt. 1996. New Venture Internationalization, Strategic Change and Performance: A Follow-Up Study. *Journal of Business Venturing* 11:23-40.

in their lives, sometimes even from the very start, are global. And this is possible because of declining costs in communication and also shipping things across borders or transferring goods and services across borders. Very often this is not just an opportunity, it's also a need, to preempt competitors from cornering a market in a specific country.

Of course, this leads to some open questions. One is, how should entrepreneurs frame international expansion decisions? Another one is, to what degree do expansion decisions of established firms differ from start-up firms? And finally, to what degree does this overconfidence bias that seems to apply when entrepreneurs look at opportunities apply internationally?

What I've found is that a global perspective on opportunities does in fact improve the performance of entrepreneurial ventures even if—and this is important—the entrepreneur eventually decides to pursue a local opportunity as opposed to a cross-border opportunity. It can very well be that, by looking at the cross-border perspectives, the entrepreneur decides, this is not such a good idea. The optimal strategy for my business model at this point in time, with the funding I can obtain, is a local one.

Now the spectrum of opportunities ranges from purely local to global. For example, enterprise software might require a presence early on in Europe and in Japan in order to gain enough of a foothold in the market, while consumer lending, another field research site I studied, might be much more of a local business than you would think, because of consumer spending habits, payback habits, and enforcement of some of these non-asset-backed contracts that get written for this kind of lending.

In terms of sequence and timing of international expansion, I found that start-ups very often follow a reverse order than established firms. Established firms, typically first established home-base exploiting sites abroad, and only then later on moved to home-base augmenting ones. Start-ups often do the opposite. They do home-base augmenting activities first, and then home-base exploiting ones. And possible explanations are that the start-up is in an acknowledged learning mode and that's more receptive to learning from abroad. But also, home-base exploiting activities typically involved high fixed costs, and start-ups are often still on a negative cash balance and are very careful in order to ensure their survival, with incurring some of these fixed costs.

Successful international expansion does create barriers to entry. There is no question about that. Now this is not about Officenet and being ethical and then being able to sell this company. This is about creating a small multinational. Creating Spotfire, the software company that has software development in Sweden and everything else in the United States, is hard. And not everybody succeeds. But if you do succeed, it puts you in a very unique position versus your competitors.

And finally, the overconfidence bias seems to be a very pronounced problem internationally, just as it is domestically. Now for this point, I couldn't establish with the data I have whether overconfidence is more of a problem internationally than it is domestically, so this would be an example for what I mentioned initially, of a research question that can be studied later with a larger data set.

Access to Resources

If you look at the third central idea, access to resources, there is, of course, a large body of literature on that. We know that, in theory, financing of an investment should be quite separate. But we know that in the real world this often doesn't apply, and firms that grow very fast—I mean if you look at Fazzari and Hubbard's[17] work, for example, in 1988—will use internal rather than external funds for their expansion. We also know that public equity markets matter for private equity markets. Black and Gilson[18] in the *JFE* have argued that public equity markets are so important for a functioning venture capital system because they allow entrepreneurs to reacquire control from venture capitalists if, after a successful IPO, the venture capitalists divest their stake and the entrepreneur again becomes the largest shareholder of a company.

Jeng and Wells[19] in an international study have found that the IPO volume in a country actually drives venture capital supply in that country, even though—this is a recent study by Hellmann[20]—just a functioning IPO market is not sufficient for an entrepreneurial culture and activity to emerge.

I've mentioned before the role of business groups in emerging markets.[21] I think this is very important, given the variance in the sample I studied. I think business groups are, in fact, an effective substitute for a lack of a venture capital market or availability of bank debt, even though entrepreneurial firms very often, at least the firms I studied, couldn't rely on that, even in the United States, because they don't provide the assets that are necessary to obtain these loans.

Cross-border listings are another important stream of literature. It's been basically argued that cross-border listings lower the cost of capital, if you look at the recent paper by Stulz, Doidge, and Krolyi,[22] because the pool of capital that becomes accessible is larger, because it's a quality signal that is being sent about the company to others, and also because there might be an enforcement of rights of shareholders if they are cross-listed. However, if you look at recent work by Jordan Siegel[23], at least for Mexican firms cross-listing in the United States, there wasn't much more protection for U.S. shareholders in these Mexican firms. So we need to see this with a grain of salt.

But, again, there are open questions regarding the financing of entrepreneurial ventures—what impact does this have on the fund-raising strategy for entrepreneurial ventures, and is there an interaction between product market strategy and financing strategy? What do I find?

I do think that if you have a global perspective on access to resources, it improves the quality of deal structures in entrepreneurial ventures and there is a clear link between financing strategy and product market strategy, at least for these privately held firms that got started by entrepreneurs. Also, the role of NGO financing, for example the IFC, can be very important because it provides some leverage in trying to force property rights to be enforced.

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[17] Fazzari, Steven M., Glenn R. Hubbard, and Bruce C. Petersen. 1988. Financing Constraints and Corporate Investment. *Brookings Papers on Economic Activity* (1):141-195.
[18] Black, Bernard S., and Ronald J. Gilson. 1998. Venture Capital and the Structure of Capital Markets: Banks versus Stock Markets. *Journal of Financial Economics* 47 (1):243-277.
[19] Jeng, Leslie A., and Phillipe C. Wells. 2000. The Determinants of Venture Capital Funding: Evidence Across Countries. *Journal of Corporate Finance* 6:241-289.
[20] Hellmann, Thomas. 2002. The Genesis of Venture Capital—Lessons from the German Experience (Working Paper). Stanford, CA: Stanford University.
[21] Khanna, Tarun, and Krishna Palepu. 2000. Is Group Affiliation Profitable in Emerging Markets? An Analysis of Diversified Indian Business Groups. *Journal of Finance* 55 (2):867-891.
[22] Doidge, Craig, G. Andrew Krolyi, and Rene M. Stulz. 2001. Why Are Foreign Firms Listed in the U.S. Worth More? (Working Paper). Columbus, OH: Ohio State University.
[23] Siegel, Jordan. 2001. Can Foreign Firms Bond Themselves Effectively by Submitting to U.S. Law? (Working Paper). Cambridge, MA: MIT.

If you look at Georgian Glass & Mineral Water, the company I talked about, they had a two-pronged strategy in order to deal with this counterfeiting problem. First they ran an advertising campaign, which is generally a no-no in marketing. You don't tell consumers that there might be something wrong with the product, because that reduces confidence more than the benefits you gain from it for your own sales. They basically violated that. They also, by the way, hired retired workers in Moscow and St. Petersburg who would go around the stores and basically just scream very loudly whenever they saw counterfeit product, which is something that store owners didn't particularly appreciate. I mean, these were two very hands-on strategies.

But a strategy that was applied in addition to that was that they got the IFC to invest, and even though the investment procedure by the IFC was very cumbersome, the IFC was able to put political pressure on Georgia to enforce at least the property rights as they applied to the water, as it came from the well to the bottling plant, because some of the water was actually being siphoned away on that pipeline. Talking about interesting "Wild East" events.

Longer funding cycles in local markets occur when there is little private equity available. And firms that seek to raise money in countries like Nigeria or Pakistan or Argentina need to consider this when they design their funding strategy.

And, finally, I think that when we think about resources, in the definition of entrepreneurship, it's about capital and people. These things are very tightly linked in entrepreneurial firms.

OK, let me briefly give you an example of Mobile Communications Tokyo. That's the company with the small CDMA chip I showed before. This company essentially, initially when it got started by this entrepreneur, couldn't obtain any outside financing. Venture capital was not available, and the company didn't have any assets because it was a design shop at the start, so bank financing wasn't available either.

The company grew profitably from the start by using some consulting income to supplement the development of these chips. It was about eight years old when an opportunity presented itself that most likely required external financing. To make a long story short, the entrepreneur didn't know this tree. The entrepreneur was an engineer who was very focused on his products, very good at developing them, designing them, but didn't know a lot about access to resources.

And what he thought when he looked at this was basically the OTC, the over-the-counter market in Japan, because the firm was large enough to be listed there. As a footnote, you don't need to be very large and you don't need to be very clean to be listed on the OTC market in Japan. But this was the strategy he thought about—this was the only strategy he saw. The Tokyo Stock Exchange, the second section, the smaller section, had listing requirements that were still above what the firm at this point had, in terms of performance and operating metrics.

Eventually, he decided to go with internal financing. He let the opportunity slip and kept financing internally. What might have been the optimal strategy would have been to take private equity from global players that started being active in Japan at the time. But the entrepreneur simply didn't know at that point in time. He was not aware of this funding tree and did not have a global perspective on access to resources.

Global Perspective and Access Combined

So if we combine these second and third ideas about global perspective and access to resources and opportunities, we can think of this as this two-by-two. Sometimes entrepreneurs might just, after studying the whole universe of opportunities and resources available to them, decide that local is best. And a firm that falls into this quadrant here would be Gray Security, the South African security firm. They did everything locally when they started out.

If you look at cross-border opportunities and local resources, Infosys, the Indian software company, initially fell into that. Spotfire, the Swedish software company, clearly was in this category because the opportunity for that software was global and the resources that the entrepreneurs found were global. And, finally, there are also companies who will have a local opportunity but use cross-border resources. Cityspace, a company that provides tourist guides and kiosks in London, falls into this quadrant.

The point here is that, I think, as an entrepreneur, to enhance the performance of a venture, it's important to understand this whole picture and then make a decision about what the optimal strategy might be.