

# Historical Military Conflict and Cross-Border VC Performance: The Role of Ownership Control

Axel Buchner,<sup>1</sup> Pia Helbing <sup>2</sup>, Abdulkadir Mohamed <sup>3</sup>  
and Hyungseok (David) Yoon <sup>3,4</sup>

<sup>1</sup>ESCP Business School, Heubnerweg 8–10, Berlin, D-14059, Germany, <sup>2</sup>University of Edinburgh Business School, University of Edinburgh, 29 Buccleuch Place, Edinburgh, EH8 9JS, UK, <sup>3</sup>Leeds University Business School, University of Leeds, Maurice Keyworth Building, Leeds, LS2 9JT, UK, and <sup>4</sup>Africa Business School, Mohammed VI Polytechnic University (UM6P), Rocade Rabat Salé, 11103, Morocco  
Corresponding author email: pia.helbing@ed.ac.uk

**This study investigates the effect of historical military conflict (between the home countries of venture capital (VC) firms and portfolio companies) on the performance of cross-border VC investments. Using exhaustive data on global cross-border investments during 1986–2017, we find that adverse memories imprinted by historical military conflict have a negative effect on cross-border performance as measured by internal rate of return and public market equivalent. We show that nation-dyadic (i.e. political affinity) and ownership control strategy (i.e. board seat and syndication)-related contingencies moderate the relationship between historical military conflict and cross-border performance. Collectively, our findings shed light on the presence of intergroup interaction challenges and mistrust when investing in cross-border VC deals and demonstrate channels to mitigate their adverse effects.**

## Introduction

In light of recent internationalization of venture capital (VC) investment (Ahlstrom and Bruton, 2006; Bruton, Ahlstrom and Yeh, 2004; Bruton, Fried and Manigart, 2005), a number of studies have explained why VC firms make cross-border investments. The reasons driving the decision to invest abroad are limited investment opportunities in a domestic market, intense domestic competition and risk diversification motives (Buch-

ner *et al.*, 2018; Gompers and Lerner, 2000). Further, some studies have found that geographic, cultural and institutional differences between the home and host countries affect cross-border performance (see Buchner *et al.*, 2018; Cumming and Johan, 2017; Cumming, Knill and Syvrud, 2016; Dai, Jo and Kassicieh, 2012; Dai and Nahata, 2016; Y. Li, Vertinsky and Li, 2014; Y. Li and Zahra, 2012; Lutz *et al.*, 2013; Meuleman *et al.*, 2017; Tykvová and Schertler, 2014).

While prior studies are increasingly insightful, scholars are increasingly being called upon to consider ‘new realities’ in international business by integrating an *international relations* perspective (Buckley, 2022; Buckley and Casson, 2021; Teece, 2020). There are three distinct streams of international relations theory that are grounded in realism, liberalism and constructivism (Snyder, 2004; Walt, 1998; Witt, 2019). The realism-based

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approach in international relations creates interstate tensions by giving prominence to state actors and national security (Lobell, 2017; Waltz, 2010). In contrast, the liberalism and constructivism-based approaches are focused on reducing tensions by promoting liberal values such as free markets and democracy, fostering economic interdependence and creating intergovernmental institutions (Keohane and Nye, 1987). Given the central role of geopolitics in today's macro-environment, it is crucial to integrate realism into an international relations perspective (Buckley, 2022; Teece, 2020).

With this in mind, this study explores the role of historical military conflict in intergroup interactions between VC firms and portfolio companies during the holding period. Given VC's heavy involvement in investment deals as investor, coach and mentor, the quality of the interactions and trust between VC firms and portfolio companies' managers during the holding period (i.e. ex-post) could affect the performance of cross-border investments. Although opportunistic behaviour and mistrust driven by adversarial international relations might not be noticeable at the time of investment, they are likely to become salient when VC firms are coaching and monitoring their portfolio start-ups (Espenlaub, Khurshed and Mohamed, 2015; Giot and Schwienbacher, 2007; Gompers and Lerner, 2001; Jääskeläinen, Maula and Seppä, 2006; Sapienza, Manigart and Vermeir, 1996; Sethuram, Taussig and Gaur, 2021) and setting up the performance milestones needed to qualify for new rounds of financing (Pahnke *et al.*, 2015). In turn, such opportunistic behaviour might not be considered by the VC firms when deciding on investments, but may hamper the performance of cross-border investments. Hence, VC firms often monitor and locate close to the portfolio companies (Bellavitis, Rietveld and Filatotchev, 2020; Lerner, 1994; Sapienza, Manigart and Vermeir, 1996) to mitigate such opportunism during the holding period.

While it is plausible to expect that VC firms would avoid investing in countries with higher levels of historical military conflict, economic consideration prevails when making cross-border investment decisions (ex-ante). This is owing to the bounded rationality problem faced by economic agents such as VC investors, as they are extremely focused on diversifying investment portfolios across different geographic locations (Manigart *et al.*, 2006) without paying much at-

tention to international relations and geopolitics. For instance, despite the historical adversarial relationship between China and Japan owing to the intense historical military conflict (e.g. genocide) in the early twentieth century, Softbank group from Japan is one of the top five shareholders of Alibaba (a Chinese e-commerce company). Although VC firms could potentially invest in hostile countries as evinced by the above case, we argue that historical military conflict induces inter-organizational challenges during the post-investment (ex-post) period and influences cross-border performance (Dushnitsky and Shaver, 2009; Katila, Rosenberger and Eisenhardt, 2008).

As such, our study aims to extend prior cross-border VC investment literature by revealing how the intergroup tension challenges between VC and portfolio company managers during the investment holding period influence cross-border performance. Further, we explore boundary conditions under which the effect of historical military conflict on performance changes. In particular, we focus on nation-dyadic and ownership control contingencies, which influence mechanisms through which historical military conflict affects VC performance. Using a unique and exhaustive global dataset on cross-border VC investment provided by the CEPRES database during 1986–2017, our results show that historical military conflict has a negative effect on cross-border performance. Next, we find that political affinity and board seat attenuate the historical military conflict–cross-border VC performance relationship, while syndication (at least partially) accentuates the relationship.

Our primary contribution is to extend prior VC studies by underscoring the importance of international relations to manage intergroup challenges in cross-border investments (Buchner *et al.*, 2018; Dai, Jo and Kassicieh, 2012; Espenlaub, Khurshed and Mohamed, 2015; Fieberg *et al.*, 2021; Sapienza, Manigart and Vermeir, 1996; Shenkar, Luo and Yehekel, 2008). Previous international business studies examine the role of international relations in foreign direct investments (Q. Li and Vashchilko, 2010; Pandya, 2016), cross-border acquisitions (C. Li *et al.*, 2020) and sovereign wealth fund investments (Knill, Lee and Mauck, 2012), which are different from cross-border VC investments. For instance, cross-border acquisitions occur between incumbent firms as acquirers and target firms with a steady cash flow. In a

similar vein, foreign direct investments are often made by established multinational enterprises and sovereign wealth fund investments are focused on investing in mature firms. Nevertheless, in cross-border VC investments, VC firms become owners of young and entrepreneurial portfolio companies. In turn, VC firms need to constantly monitor and interact with the portfolio company throughout the holding period. Since coaching and dynamic interactions are salient during the investment holding period, an insight into the international relations between the VC and portfolio company in cross-border investments is interesting and novel.

Finally, we provide new insights into how VC firms deal with intergroup tensions and interaction challenges. Our contingency approach of investigating the inter-relationships provides a basis for understanding the roles of control and collaboration that are pivotal to the success in today's new normal landscape for international business (Felin and Foss, 2005; Foss and Pederson, 2019; Raisch, Hargrave and Van De Ven, 2018).

## Theory and hypotheses

According to the realism-based approach of international relations, historical military conflict is considered one of the most salient and consequential components of international relations (Deutsch, 1973; Jones, Bremer and Singer, 1996), which can have a long-lasting imprinting effect on the countries involved and their populations' collective memories, attitudes and behaviours over generations (Arikan, Arikan and Shenkar, 2020; Deutsch, 1973; Mosse, 1991). With this in mind, we view the VC–portfolio company relationship through the lens of intergroup relations theory, which addresses the role of social categorization and social identity/status (Tajfel, 1982; Tajfel and Turner, 1979) in intergroup tensions between organizations originating from different countries (C. Li *et al.*, 2020). In negotiations and social identity research, adverse memories imprinted on individuals have been shown to affect in-group versus out-group identification, as well as interaction dynamics and negotiation outcomes (Tse, Francis and Walls, 1994). Such adverse memories can create unfavourable social perceptions and cognitive biases (Pruitt and Rubin, 1986). For example, the categories of in-group and out-group are formed based on national animosity or similarity

of (national) traits between VC firms and portfolio companies (Arikan, Arikan and Shenkar, 2020). Generally, individuals implicitly perceive, retain and process information about in-group members more favourably than out-group members (Hamilton and Troler, 1986).

In the context of the VC–portfolio company relationship, if managers or employees of a portfolio company have negative collective memories about a VC firm in view of historical military conflict, then they would label that VC firm as an out-group (Arikan and Shenkar, 2013). Such a biased and prejudiced categorization would result in contrasting parameters hampering their interaction quality and trust during the holding period. Subsequently, our predictions articulate how cognitive and effective interaction processes and trust between VC firms and portfolio companies are shaped by historical military conflict (Abrams and Hogg, 1988; Tajfel and Turner, 1979, 1986). Given that individuals in general – and those working for organizations – use nationality as the dominant sense-making vehicle for intergroup relations in international settings (Salk and Shenkar, 2001), we postulate that historical military conflict creates intergroup tensions and mistrust, hindering smooth interactions and cooperation (C. Li *et al.*, 2020). This is pertinent during the holding period of cross-border investment, which is characterized by frequent interactions between VC firms and portfolio companies.

### *Historical military conflict and cross-border VC performance*

Historical military conflict between two nations is likely to affect individual behaviour in each of the nations, either contemporaneously or backward looking through inherited historical interpretations from past generations (Arikan, Arikan and Shenkar, 2020). Since memories accumulate over time, the remembrance of these collective assets is likely to be influential in the group context (Halbwachs, 1939). Further, individuals are affected by national sentiments shaped by how history is retained in the minds of individuals as a collective memory (Klein and Etneso, 1999). Although some country-dyadic relations have normalized even after intense conflict, many, if not all, military conflicts and their consequences have been passed down over the generations and are still subject to the collective memories of the countries involved

(Halbwachs, 1992; Mosse, 1991; D. Wang, Du and Marquis, 2019). Hence, the collective memory formed by historical military conflict is manifested as stereotyping and directly applies to the formation of animosity and amity (Arikan and Shenkar, 2013; Linville, Salovey and Fischer, 1986). If decision-makers have a negative collective memory about their counterparts, then they could label them an out-group out of animosity (Arikan, Arikan and Shenkar, 2020). Thus, it is reasonable to posit that frequent historical military conflict leads to considerable stereotyping and prejudice towards the antagonistic country (Bar-Tal, 2000; Guiso, Sapienza and Zingales, 2009).

Subsequently, the unfriendly attitudes and behaviours derived from frequent historical military conflict can be detrimental to the quality of interactions between the two parties, which is a critical element in cross-border investments. The quality of interaction is highly relevant because the general partners of VC firms frequently provide advice and monitoring to their portfolio companies during the holding period (Buchner *et al.*, 2018; Hain, Johan and Wang, 2016). For instance, VC firms are usually involved with their portfolio companies for 3–10 years and then exit (Kaplan and Strömberg, 2009), creating a context whereby sentiment due to historical military conflict could influence the outcome of cross-border investment over many years. In contrast to cross-border acquisitions, VC firms interact with the portfolio company during the holding period, but eventually exit the investment based on contractual agreements with the portfolio company. If unfriendly attitudes prevail in the VC–portfolio company interaction, then members of the two parties will resist each other in conflicting relationships rather than working together to reap the benefits of VC investment (Verbeke, 2010).

In addition, intergroup categorization derived from accumulated historical military conflict between the home countries of VC firms and portfolio companies could cause a shift in power distribution between the principal and agent, inducing redundant rivalry and agent opportunism. In this sense, greater accumulation of historical military conflict can give rise to the portfolio company's opportunistic behaviour (e.g. breach of property and control rights, contract enforcement issues) by taking advantage of its home-country environment, after the investment has been committed by VC firms (Arikan and Shenkar, 2013; Dinc and

Erel, 2013; Kim, Steensma and Park, 2019). Opportunism prevents reaping benefits from the VC firm's involvement as investor, coach and mentor, such as extraction of synergies and unfolding of the portfolio company's creative potential (Shenkar, Luo and Yeheskel, 2008). Hence, such behaviour complicates collaboration and interaction processes between VC firms and portfolio companies, thereby diminishing the value creation potential of VC investment.

Given the above premises, we argue that intergroup tension is likely to rise with the greater accumulation of historical military conflict. As individuals associate themselves with their home country, we expect historical military conflict to induce negative sentiments affecting individuals' level of trust, compromising the quality of interactions between VC firms and portfolio companies (Arikan and Shenkar, 2013). Historical military conflict not only diminishes relational trust between VC firms and portfolio companies, but also institutional trust towards the home countries of VC firms and portfolio companies (Hain, Johan and Wang, 2016). As diminishing trust could create a hostile attitude and prevent smooth interaction, cross-border VC investment in countries with historical military conflict is likely to lead to recurring, in-depth friction between VC firms and portfolio companies (Gao, Wang and Che, 2018). Thus, frequent and in-depth friction increases agency and oversight costs, leading to negative performance outcomes for VC firms (Kaplan and Strömberg, 2001; Lerner, 1995).

In sum, cross-border VC investment in countries with historical military conflict can induce partner-related opportunism and create mistrust and tensions between VC firms and portfolio companies, leading to moral hazard and intergroup tensions (Dai and Nahata, 2016; Hain, Johan and Wang, 2016; Kim, Steensma and Park, 2019). Therefore, we formally hypothesize that a higher degree of historical military conflict is likely to decrease internal rate of return (IRR) and public market equivalent (PME).<sup>1</sup>

*H1:* There is a negative relationship between cross-border VC performance and historical military

<sup>1</sup>Our deal-level performance measures are based on cross-border deals that are fully realized and exited by the VC (3746 deals).

conflict between the home countries of the VC firms and their portfolio companies.

*Political affinity, historical military conflict and cross-border VC performance*

H1 suggests that VC firms originating from countries characterized by historical military conflict with the countries of portfolio companies are likely to face intergroup tensions, opportunism and mistrust. Here we argue that VC firms will be able to mitigate agency problems and intergroup tensions (Bertrand, Betschinger and Settles, 2016; Fieberg *et al.*, 2021; Hasija, Liou and Ellstrand, 2020) by considering contemporary political affinity. Political affinity is a yearly measure capturing the degree of alignment in national interests between two countries that are shaped by a variety of factors including governing structures, political culture and idiosyncratic political agendas (Gartzke, 2000). Enhancing political affinity is less likely to cause dispute and pose a threat to each other's national interests (see Bertrand, Betschinger and Settles, 2016; Fieberg *et al.*, 2021; Gao, Wang and Che, 2018; Hasija, Liou and Ellstrand, 2020; C. Li *et al.*, 2020).

Higher levels of political affinity expose VC firms to fewer intergroup tensions and less opportunism derived from the negative sentiment imprinted by historical military conflict (Yoon, Peillex and Buckley, 2021). In other words, political affinity driving the (gradual) decline of the negative sentiment can offset the pitfalls of opportunism and intergroup tensions affecting VC performance (Fieberg *et al.*, 2021; Yiu *et al.*, 2021). Thus, we expect the negative effect of historical military conflict on cross-border performance to be weakened with higher political affinity (e.g. which is likely to exhibit cultural similarities) between the countries of VC firms and portfolio companies. Formally:

*H2: Political affinity between the home countries of the VC firms and their portfolio companies attenuates the negative effect of historical military conflict on cross-border performance.*

*Ownership control, historical military conflict and cross-border VC performance*

The next two hypotheses explain how the ownership control strategy influences the ability of VC

firms to mitigate the intergroup tensions derived from historical military conflict. Prior studies on the risk of opportunism (Dow, Baack and Parante, 2020; Zhou and Xu, 2012) underscore the need for VC firms to ensure sufficiently high levels of control needed to allow VC firms to confidently transfer advanced knowledge to the portfolio company for improved VC performance. In contrast, other studies stressing value creation (e.g. the knowledge-based perspective of Kogut and Zander, 1995) emphasize the need for VC firms to have high levels of collaboration with other VC firms through syndication, to mobilize more resources to diversify risks. Based on these two ownership control strategies (Li *et al.*, 2009; Sundaramurthy and Lewis, 2003), H3 and H4 theorize the moderating role of board seat and syndication.

Holding a board seat in the portfolio company would provide VC firms with some level of control. VC firms can exercise voting rights and impose restrictions, if necessary, on portfolio companies during their involvement (Gompers, 1995; Kaplan and Strömberg, 2001). Further, a board seat allows VC firms to mitigate information asymmetry and monitor executive behaviour in the portfolio companies (Eisenhardt, 1989; Gabriellsson and Huse, 2002; Humphery-Jenner, Sautner and Suchard, 2017). Nevertheless, holding a board seat in the portfolio company may induce slower decision-making processes, less candid discussions of managerial performance and biases against risk-taking (Yermack, 1996). Although having external board members from VC firms could bring a breadth of knowledge and different approaches to problem-solving, it might exacerbate the adverse effects of historical military conflict (Keller, 2001).

Despite the contrasting arguments on the role of a board seat, we assume that the benefits of having a board seat outweigh its costs, thereby mitigating the negative relationship between historical military conflict and VC performance. For instance, while historical military conflict increases the uncertainty regarding the intergroup tensions and conflicts, VC firms taking a board seat are able to increase the oversight and effective monitoring of their portfolio companies. Since VC firms and portfolio companies use each other's nationality as their sense-making vehicle (Salk and Shenkar, 2001), leading to intergroup tensions, having a board seat in a portfolio company gives the VC firms confidence in dealing with intergroup problems. In addition, a lack of governance for VC

firms in the portfolio companies can lead to greater tensions between VC and portfolio companies, resulting in portfolio companies' opportunistic behaviour and difficult interactions. With better hierarchical control, VC firms can minimize opportunistic behaviour and mitigate intergroup tensions (Kaplan and Strömberg, 2001) due to historical military conflict between the home countries of VC firms and portfolio companies.

In sum, we expect the negative effect of historical military conflict on cross-border performance to be weaker when VC firms hold a board seat in the portfolio companies. Formally:

*H3:* Holding a board seat attenuates the negative effect of historical military conflict on cross-border VC performance.

A diverse VC consortium consisting of foreign VC firms and local VC firms would be under considerable pressure when historical military conflict leads to animosity, hatred and prejudice (Bar-Tal, 2000; Guiso, Sapienza and Zingales, 2009). Subsequently, the VC syndication could lead to possible frictions between the different VC firms on handling the adverse outcome of the portfolio company in an unfriendly country (Kim and Park, 2021). In this sense, where VC firms face a higher degree of historical military conflict, competitive alliance partners could augment the conflicts of interest, with the possibility of detrimental intellectual property 'leakage' and the risk of social capital appropriation (Makarevich, 2018). Moreover, owing to the competitive tension in syndication, VC firms might not be able to effectively deal with problems associated with intergroup interactions and reduce the opportunism of the portfolio company, induced by frequent military conflicts between the home countries of VC firms and portfolio companies.

In sum, we expect the negative effect of historical military conflict on cross-border performance to be strengthened when VC firms syndicate with diverse partners. Formally:

*H4a:* Syndications consisting of diverse members accentuate the negative effects of historical military conflict on cross-border VC performance.

Despite the challenges of diverse VC syndication to manage portfolio companies located in countries with higher levels of military conflict, such a syndication enables VC firms to diversify the risks associated with their portfolio company

(Lerner, 1994; Manigart *et al.*, 2006). Syndications allow VC firms to share risk and to access valuable resources by forming inter-VC alliances (Ferrary, 2010; Hopp and Rieder, 2011; Makarevich, 2018; Wright and Lockett, 2003). In this sense, syndications help VC firms to effectively deal with problems associated with intergroup interactions by mitigating information asymmetry and adverse selection problems (Bellavitis, Rietveld and Filatotchev, 2020; Lockett and Wright, 2001) through active and collective monitoring (Jensen and Meckling, 1976).

In sum, we expect the negative effect of historical military conflict on cross-border performance to be weakened when VC firms syndicate with diverse partners. Formally:

*H4b:* Syndications consisting of diverse members attenuate the negative effect of historical military conflict on cross-border VC performance.

## Methods

### *Data and sample*

This study relies entirely on proprietary data obtained from a private consulting company, the Centre for Private Equity Research (CEPRES). CEPRES gathers data from private capital firms that participate in a general-partner network. Firms that participate in this network report monthly cash flows and investment details (e.g. industry, investment stage, etc.) for each deal they have made in the past. This allows us to compute the IRR and PME at individual deal level. Other databases (including VentureXpert) provide IRR at the fund level. CEPRES complies with the confidentiality requirements of the private capital industry, which helps to improve data accuracy and representativeness by limiting self-reporting bias. This means that no third parties are able to identify the performance of individual firms, funds or managers. The importance of such anonymity is that it eliminates the incentives for VC and private equity firms to overstate the results they report to CEPRES. The lack of anonymity in other databases may result in overstating and backfilling information, a situation that amounts to positive self-reporting bias.<sup>2</sup> CEPRES data are

<sup>2</sup>The database does not provide detailed information on the types of partners involved in the syndication.

used in a number of studies, including those of Krohmer, Lauterbach and Calanog (2009), Cumming, Schmidt and Walz (2010), Franzoni, Nowak and Phalippou (2012) and Espenlaub, Khurshed and Mohamed (2015). In our research design, investigating the effect of historical military conflict and political affinity on performance is more meaningful at investment deal level than at fund level. Since the fund might invest in multiple countries, the relationship between cross-border investments and historical military conflict might not be clear and could be distorted.<sup>3</sup>

In addition, we use the Military Interstate Dispute (MID) and Correlates of War (COW) databases to operationalize our main variables of interest. The MID database is carefully constructed through a panel of international relations faculty quantifying events of conflict. These implicit or explicit tensions arising from actions between nations are weighted by the severity of the type of event, ranging from verbal attacks to military action (Goldstein, 1992). It is noted that indirect and implicit aggressions of conflict are also quantified (see Online Appendix OA.2 for details).

Our sample of cross-border investments includes fully realized (i.e. exited) investments (Jääskeläinen and Maula, 2014). This is mainly because the performance of VC investments can only be calculated when the VC firms have fully exited the investments (Dai, Jo and Kassiech, 2012). Nevertheless, we account for possible bias in our results associated with unrealized or only partially realized deals using sample selection methods. Consistent with the literature, we define an investment as cross-border if a portfolio company is located in a country different from the home country of the VC firm's headquarters (Buchner *et al.*, 2018). Our international sample includes four regions: North America (1173 deals); Europe, excluding the United Kingdom (1022 deals); the United Kingdom (763 deals); and the rest of the world (ROW, 788 deals). In Table OA.4 we further report the breakdown of portfolio company location by VC home country. Based on the sample dis-

tribution, there is no evidence to suggest that our results might be driven by a few country pairs.<sup>4</sup>

### Variables

*Dependent variables.* We use IRR as a time-sensitive absolute measure of performance, computed as the discount rate which equates the present value of the net cash flow to zero. The CEPRES database provides information on the cash flows invested from entry to exit, including dividend repayments and proceeds from exit. We use PME as an alternative measure of performance; this is computed by discounting the VC investment's cash inflow and outflow relative to a public benchmark in the VC home country (Buchner *et al.*, 2018).<sup>5</sup>

*Independent and moderating variables.* The military conflict approximates the opposing militarized actions between two countries (Arikan, Arikan and Shenkar, 2020; Deutsch, 1973). The MID database provides militarized events that one country initiates against the government, official representatives, forces, property or territory of another country (Ghosn and Bennett, 2003; Jones, Bremer and Singer, 1996). These militarized events include the explicit threat to resort to armed forces, the display or mobilization of armed forces, the use of armed forces short of war, or war involving at least 1000 fatalities (Ghosn, Palmer and Bremer, 2004). We construct the accumulated militarized actions starting from 1918 weighted by the severity of the intervention. We follow C. Li *et al.* (2020) using the scale developed by Goldstein (1992) to weigh different types of conflict, direct or indirect, based on their severity. This classification scheme is in line with our theory, because more severe military conflict tends to have a longer-lasting and more severe imprinting effect on a country's population.<sup>6</sup>

As a moderator, we use yearly political affinity, which measures the degree of closeness of votes at United Nations' General Assemblies between states (Gartzke, 2000). This measure has been used in several recent international business

<sup>3</sup>The CEPRES database does not provide any indicator for relocation of the portfolio company during the investment holding period. This potentially might be a concern, but a randomized search of 30% of the portfolio companies' locations shows that the locations are the same as reported in the database.

<sup>4</sup>We thank an anonymous referee for pointing out the importance of analysing the sample distribution.

<sup>5</sup>Table OA.1 summarizes information on the panel data variables used in the main analysis.

<sup>6</sup>Please refer to the Online Appendix OA.2 for conceptualizing and operationalizing of the measure.

studies (Bertrand, Betschinger and Settles, 2016; Fieberg *et al.*, 2021; Hasija, Liou and Ellstrand, 2020). We use the COW database to construct and merge the political affinity measure with our cross-border VC investments dataset. In the assembly, members have the choice between three voting options: approve, disapprove or abstain on an issue. Using this voting data, the value of political affinity ranges between  $-1$  and  $+1$ , where the country dyads made completely opposite votes or the country dyads had an identical voting pattern, respectively (Bertrand, Betschinger and Settles, 2016; Hasija, Liou and Ellstrand, 2020). The measure is calculated as follows:

$$\text{Political Affinity}_{t}^{i,j} = 2 \frac{D_t(V_t^i, V_t^j)}{D_t^{\max}}$$

where  $D_t$  is the sum of the metric distance (in absolute value) between  $V_{it}$  and  $V_{jt}$  of each country, and  $D_t^{\max}$  denotes the largest distance between those votes. Following D. Wang *et al.* (2021), we compute an alternative measure for political affinity, which is year-varying and median-based, on the country dyad level retrieved from the GDELT database (Leetaru and Schrod, 2013). The corporation event measure approximates news events and classifies based on the Goldstein (1992) framework:<sup>7</sup>

$$\text{Cooperation Events} = \log \left( \sum (f_{\text{coop}})(w_{\text{coop}}) + 1 \right)$$

Addressing skewness and the diminishing effects of multiple events, we log-transform the product of the frequency of news events ( $f_{\text{coop}}$ ) and scores ( $w_{\text{coop}}$ ), similar to Davis, Fuchs and Johnson (2019).

Our variable of interest (i.e. historical military conflict) is not influenced by the characteristics of VC activities, and this suggests that the effect of historical military conflict is likely to be one way, with reverse causality an unlikely outcome. Therefore, the issue of endogeneity is not a concern for our variables of interest (i.e. historical military conflict).

We include other moderators such as board seat and syndication. Board seat is an indicator that takes the value one if the VC firm takes a

board seat in the portfolio company, and zero otherwise (Gabrielsson and Huse, 2002; Gompers, 1995). Syndication is a dummy variable that takes the value one if the cross-border investments are syndicated between lead foreign VC firms and local VC firms, and zero otherwise (Tykvoová and Schertler, 2014). Finally, we approximate VC-specific experience as the number of deals a general partner has done in the past in the same country as the current deal. VC international experience is measured as the number of deals a general partner has done in the past in countries other than his/her main office prior to the current deal.

*Control variables.* We include various distance measures that have been attributed to influence cross-border performance. We measure the geographical distance in miles between the countries' capitals (Dai, Jo and Kasscieh, 2012; Lutz *et al.*, 2013); the cultural distance is based on Hofstede's measures (Dai and Nahata, 2016; Hofstede and Bond, 1988) and the regulatory distance is constructed using the regulatory quality score (Y. Li and Zahra, 2012). We approximate the political stability distance by the differences in stability score and the legal system between home and host country (La Porta *et al.*, 1998; Y. Li, Vertinsky and Li, 2014). The government fractionalization index of the portfolio country measures the degree of power sharing (Beck *et al.*, 2001).

Furthermore, to consider the economic opportunity residing in the country of the portfolio company, we use the host country's GDP growth (Arikan, Arikan and Shenkar, 2020; C. Li *et al.*, 2020), foreign direct investment (FDI) amount, unemployment rate and trade openness (Jeng and Wells, 2000; Yoon, Peillex and Buckley, 2021) collected from the World Bank, and initial public offering (IPO) activity retrieved from Refinitiv. Since exit opportunity is influenced by economic conditions, these variables are likely to influence whether or not the cross-border investments are fully realized.

Moreover, we include VC-specific variables such as VC firm's age, investment size and fund age (Buchner *et al.*, 2018; Dai, Jo and Kasscieh, 2012; Meuleman *et al.*, 2017). We measure stock market liquidity similarly to Lutz *et al.* (2013). Finally, we

<sup>7</sup>Following Wang *et al.* (2021), to focus on material events we only count events that score larger than  $+5.2$ .



control for the year, financing stage and industry fixed effects in all our analysis.<sup>8</sup>

## Results

### *Preliminary analysis*

Table 1 reports the mean, median and standard deviation of the variables based on the national origin of the VC firms. As expected, the investment size is large and VC firms are mature, as measured by age, in North America. The investment holding period is shorter for VC firms located in the rest of the world than those located in North America, Europe or the United Kingdom (Kaplan and Strömberg, 2009). European VC firms invest most of their capital in seed deals, while UK and North American VC firms invest in early-stage investments, consistent with industry reports (see Invest Europe, 2020). Political affinity between the home countries of VC firms and portfolio companies is highest for the European Union and lowest for North America. This suggests that VC firms from the European Union tend to invest in countries with which they have strong relationships and similar national interests. It is evident from the table that North American VC firms finance deals that are geographically and culturally distant from their countries, unlike VC firms located in the United Kingdom, European Union or rest of the world. The economic opportunity proxies, as measured by GDP growth, FDI and unemployment rates, are relatively higher in the rest of the world compared to North America, the United Kingdom and Europe. Meanwhile, IPO activity and trade openness are higher for VC firms located in North America, Europe and the United Kingdom.

In line with prior empirical evidence (Cumming and Zambelli, 2013), write-off rates for VC firms originating in EU countries (18.90%) are the highest, followed by the United Kingdom (14.90%) and North America (13.30%). It is not surprising that exits through IPO and merger and acquisition (M&A) routes are higher in the United Kingdom, Europe and North America than the rest of the world, because of developed capital markets in these regions (Groh, von Liechtenstein and Lieser, 2010).

<sup>8</sup>Our results remain robust, including year fixed effects as reported in Table OA.9, Model I.

### *Econometric models and tests of hypotheses*

Our analysis is based on cross-border deals that are exited (realized), while some of the investments are not exited (unrealized) by the end of the sample period. Similarly, the cross-border performance is influenced by the choice of cross-border investment. Possibly these two issues might induce bias to our analysis. To address these concerns, we use two-stage Heckman models (Tables 2 and 3) with two estimates of stage I probability, similar to Espenlaub, Khurshed and Mohamed (2015). The extended Heckman model estimates (i) the probability of fully realizing investments and (ii) the likelihood of cross-border investment. Since the standard error might be biased, we use a bootstrapped standard error to overcome this problem. Our exclusion criteria in stage I include proxies for host countries' economic opportunity, which influences the probability of cross-border investments and the likelihood of exiting investments. We measure the host country's economic opportunity using GDP growth, FDI movement, unemployment rate, IPO activities and trade openness. Since VC firms are associated with their cross-border portfolio companies over a longer period, the impact of economic opportunity at the time of cross-border investment might influence the decision to invest more than the expected performance VC firms. Hence, this satisfies the exclusion restrictions criterion. In the second stage, we employ ordinary least squares (OLS) models for a sample of fully realized deals and control the sample selection and choice of cross-border investment with an inverse Mills ratio.

The results for the probit models (stage I) are reported in Table 2 and show that IPO activity and economic opportunities indeed increase the exit probability of cross-border investment choice. Model I shows that historical military conflict has a negative impact on IRR, while political affinity has a positive impact on performance – controlling for distance-specific and VC firm characteristics, industry, country and financing stage fixed effects. Models II–IV show the moderating effects of political affinity, board seat and syndication, respectively. The interaction term of political affinity in Model II is positive and statistically significant. In economic terms, a one standard deviation increase in historical military conflict decreases the performance by approximately 10%. Nevertheless, in countries with higher political affinity the

Table 1. Descriptive statistics: mean, median and standard deviation for the variables of interest across national origin of the VC investment

Variables	North America			United Kingdom			European Union			Rest of the world		
	Mean	Median	STD	Mean	Median	STD	Mean	Median	STD	Mean	Median	STD
<b>VC characteristics</b>												
VC age	19.152	19.580	10.384	19.323	23.170	11.934	10.833	9.085	7.566	6.572	5.330	5.083
Fund age	1.863	1.420	1.968	2.232	1.580	2.389	1.975	1.250	2.187	2.908	1.670	3.383
Investment size (m)	14.056	6.170	25.549	11.221	6.000	24.492	4.130	2.295	5.974	9.450	3.845	20.703
Investment duration	3.928	3.083	3.291	4.347	3.917	2.991	4.210	3.833	2.791	3.474	3.000	2.688
Stock market LiQ	57.655	46.531	58.069	98.249	69.540	86.731	88.556	59.352	88.676	103.981	81.966	93.173
Syndication	0.365	0.000	0.482	0.471	0.000	0.499	0.508	1.000	0.500	0.411	0.000	0.492
Board seat	0.521	1.000	0.500	0.431	0.000	0.496	0.517	1.000	0.500	0.492	0.000	0.500
Seed stage	0.031	0.000	0.173	0.005	0.000	0.072	0.099	0.000	0.299	0.011	0.000	0.106
Early stage	0.371	0.000	0.483	0.488	0.000	0.500	0.239	0.000	0.427	0.180	0.000	0.385
Expansion stage	0.165	0.000	0.372	0.109	0.000	0.312	0.114	0.000	0.319	0.169	0.000	0.375
Later stage	0.116	0.000	0.320	0.111	0.000	0.315	0.023	0.000	0.152	0.053	0.000	0.225
IPO exits	0.065	0.000	0.246	0.109	0.000	0.312	0.092	0.000	0.289	0.077	0.000	0.267
M&A exits	0.115	0.000	0.319	0.152	0.000	0.359	0.116	0.000	0.321	0.100	0.000	0.301
Write-offs	0.133	0.000	0.340	0.149	0.000	0.357	0.189	0.000	0.392	0.129	0.000	0.336
<b>Distance and friction characteristics</b>												
Historical military conflict	55.359	48.400	103.958	26.600	19.111	35.441	23.202	17.600	28.682	29.593	26.141	73.029
Political affinity	0.1558	0.103	0.421	0.485	0.432	0.287	0.517	0.373	0.382	0.493	0.481	0.419
Geographical distance	4863.256	4170.000	2171.238	2593.651	3665.000	1576.574	2282.798	1802.000	1738.505	2942.958	1299.000	2478.828
Cultural distance	11.488	14.020	7.057	8.127	3.221	6.189	8.648	7.818	4.755	9.355	6.951	5.618
Regulatory distance	0.476	0.230	0.782	0.355	0.112	0.377	0.174	0.144	0.155	0.268	0.145	0.124
Political stability distance	0.180	0.000	0.758	0.178	0.000	0.680	0.257	0.000	0.704	0.285	0.000	1.155
Legal system difference	0.519	1.000	0.499	0.315	0.000	0.264	0.577	1.000	0.294	0.501	1.000	0.201
Government fraction index	0.577	0.667	0.266	0.603	0.505	0.166	0.627	0.537	0.149	0.460	0.503	0.273
<b>Economic opportunity</b>												
GDP growth (host)	4.447	3.437	3.837	3.617	3.772	2.339	3.437	3.232	2.113	5.473	4.127	3.881
FDI movement (host)	57900	29100	6700	69100	21700	11900	103000	55900	11400	136000	117000	11500
Unemployment (host)	6.740	5.720	2.921	6.792	5.721	3.507	6.493	5.651	2.538	5.421	4.621	2.282
IPO activity (host)	186.158	100.00	25.141	181.630	101.112	22.410	158.91	102.22	24.541	59.391	38.120	24.110
Trade openness (host)	71.165	56.263	51.851	50.320	27.955	39.269	53.380	50.791	38.926	58.241	49.551	47.736
<b>N</b>	<b>1173</b>		<b>763</b>	<b>763</b>		<b>1022</b>	<b>1022</b>		<b>788</b>			
<b>Panel B</b>												
IRR	0.315	0.273	0.445	0.265	0.211	0.388	0.221	0.185	0.488	0.308	0.234	0.213
PME (home)	1.398	0.906	1.053	1.627	1.083	1.491	1.887	1.162	1.156	1.439	1.287	1.730
<b>N</b>	<b>1173</b>		<b>763</b>	<b>763</b>		<b>1022</b>	<b>1022</b>		<b>788</b>			

Table 2. Two-stage extended Heckman model (IRR). The table presents the results of extended Heckman with two-stage probability models. The first column reports the probability of investing in a cross-border investment using both cross-border and domestic investments. The second column shows the probability of exit, including all exited and unexited cross-border VC investments. The third column shows the second-stage results of the Heckman model, where the dependent variable is the IRR. The coefficients represent the effect of a unit change on the IRR, given that all other variables are held constant. The p-value for this statistic is reported in parentheses. The independent variables are categorized into distance and control variables, including fixed effects. The interaction terms represent the multiplication of the historical military conflict with the dummy of (i) high political affinity, (ii) board seat and (iii) syndication

Variables	Probit I: Cross investments		Probit II: Unrealized deals		Second stage: OLS			
	Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val
Historical military conflict × High political affinity			0.040	(0.04)				
Historical military conflict × Board seat					0.020	(0.03)		
Historical military conflict × Syndication							0.120	(0.02)
<b>Distance and friction characteristics</b>								
<b>Historical military conflict</b>								
Political affinity	-0.132	(0.00)	0.192	(0.00)	-0.113	(0.02)	-0.080	(0.03)
High political affinity (dummy)	0.055	(0.03)	-0.025	(0.02)	0.148	(0.00)	0.166	(0.02)
Cultural distance	-0.011	(0.07)	0.002	(0.08)	0.001	(0.12)	0.048	(0.02)
Regulatory distance	-0.013	(0.06)	-0.003	(0.06)	0.004	(0.08)	0.001	(0.11)
Political stability distance	-0.042	(0.03)	0.031	(0.08)	0.048	(0.03)	0.001	(0.32)
Legal system	0.085	(0.02)	-0.080	(0.03)	-0.020	(0.07)	-0.045	(0.00)
Government fractionalization index	0.078	(0.03)	-0.071	(0.02)	-0.037	(0.02)	-0.015	(0.26)
	0.122	(0.02)	0.131	(0.03)	-0.155	(0.02)	0.006	(0.12)
<b>Economic opportunity</b>								
GDP growth (host)	0.034	(0.03)	0.033	(0.02)				
FDI movement (host)	0.018	(0.00)	0.0162	(0.00)				
Unemployment (host)	0.015	(0.00)	0.0141	(0.00)				
IPO activity (host)	0.181	(0.00)	0.162	(0.00)				
Trade openness (host)	0.022	(0.04)	-0.015	(0.02)	0.001	(0.31)	0.002	(0.21)
<b>Control variables</b>								
VC age	0.041	(0.00)	0.038	(0.00)	0.023	(0.04)	0.022	(0.03)
Fund age	0.021	(0.00)	0.084	(0.00)	0.087	(0.00)	0.021	(0.04)
Investment size	0.052	(0.00)	-0.061	(0.00)	0.035	(0.01)	0.012	(0.02)
Investment duration	0.021	(0.00)	0.016	(0.00)	0.027	(0.00)	0.012	(0.00)
Stock market LiQ	0.021	(0.00)	0.020	(0.02)	0.001	(0.00)	0.001	(0.00)
Post-1997	-0.312	(0.00)	-0.405	(0.00)	-0.038	(0.03)	-0.100	(0.00)
Syndication	0.041	(0.03)	-0.036	(0.07)	0.017	(0.00)	0.032	(0.01)
Board seat	0.063	(0.00)	-0.078	(0.00)	-0.029	(0.04)	-0.031	(0.04)
Inverse Mills I					0.016	(0.14)	0.019	(0.09)
Inverse Mills II					0.019	(0.16)	0.021	(0.07)
<b>Fixed effects</b>								
FE – Industry	Y		Y		Y		Y	
FE – Country	Y		Y		Y		Y	
FE – Stage finance	Y		Y		Y		Y	
Adj. R-squared	0.188		0.161		0.101		0.104	
N	8296		4768		3746		3746	

Table 3. Two-stage extended Heckman model (PME). The table reports the second stage considering the realized cross-border VC investments and the effect of the variables of interest on VC performance. The first-stage models are similar to that reported in Table 2. The dependent variable is the PME in the second stage, instead of the IRR. The coefficients represent the effect of a unit change on the PME, given that all other variables are held constant. The p-value for this statistic is reported in parentheses. The independent variables are categorized into distance and control variables, including fixed effects. The interaction terms represent the multiplication of the historical military conflict with the dummy of (i) high political affinity, (ii) board seat and (iii) syndication

Variables	Second stage: OLS								
	Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val	
			0.010	(0.03)					
					0.060	(0.02)			
							0.250	(0.03)	
Distance and friction characteristics	<b>Historical military conflict</b>	-0.058	(0.00)	-0.100	(0.02)	-0.040	(0.03)	-0.040	(0.02)
	Political affinity	0.069	(0.04)			0.079	(0.04)	0.088	(0.02)
	High political affinity (dummy)			0.096	(0.02)				
	Geographical distance	0.002	(0.18)	0.000	(0.18)	0.000	(0.16)	0.000	(0.18)
	Cultural distance	0.005	(0.13)	0.002	(0.57)	0.004	(0.15)	0.004	(0.12)
	Regulatory distance	0.066	(0.04)	0.048	(0.05)	0.061	(0.01)	0.061	(0.01)
	Political stability distance	-0.038	(0.02)	-0.001	(0.95)	-0.046	(0.03)	-0.042	(0.05)
	Legal system	-0.020	(0.07)	-0.011	(0.07)	-0.016	(0.08)	-0.014	(0.06)
	Government fractionalization index	-0.143	(0.06)	-0.147	(0.05)	-0.133	(0.07)	-0.111	(0.09)
Economic opportunity	GDP growth (host)								
	FDI movement (host)								
	Unemployment (host)								
	IPO activity (host)								
	Trade openness (host)	0.002	(0.07)	0.001	(0.05)	0.001	(0.07)	0.001	(0.05)
Control variables	VC age	0.034	(0.05)	0.016	(0.02)	0.044	(0.00)	0.039	(0.01)
	Fund age	0.095	(0.00)	0.078	(0.00)	0.070	(0.00)	0.076	(0.00)
	Investment size	0.045	(0.00)	0.022	(0.05)	0.027	(0.02)	0.029	(0.01)
	Investment duration	0.025	(0.00)	0.036	(0.00)	0.031	(0.00)	0.030	(0.00)
	Stock market LiQ	0.002	(0.06)	0.001	(0.06)	0.000	(0.08)	0.000	(0.09)
	Post-1997	-0.102	(0.04)	-0.06	(0.09)	-0.105	(0.05)	-0.086	(0.04)
	Syndication	0.049	(0.02)	0.057	(0.02)	0.057	(0.02)	0.073	(0.01)
	Board seat	-0.039	(0.02)			-0.044	(0.03)		
	Inverse Mills I	0.015	(0.19)	0.022	(0.07)	0.018	(0.17)	0.013	(0.17)
	Inverse Mills II	0.020	(0.16)	0.020	(0.08)	0.022	(0.22)	0.019	(0.19)
	Fixed effects	FE – Industry	Y		Y		Y		Y
FE – Country		Y		Y		Y		Y	
FE – Stage finance		Y		Y		Y		Y	
Adj. R-squared		0.116		0.102		0.114		0.115	
N		3746		3746		3746		3746	

performance is positive, at 3%. The fact that better political affinity moderates the negative effect of historical military conflict is consistent with C. Li *et al.* (2020), due to the inverse relationship between political affinity and cultural difference. The authors show that higher cultural differences (i.e. low political affinity) negatively influence cross-border performance. Our results show that high political affinity (i.e. low cultural difference) mitigates the negative effect of historical military conflict on performance. Models III and IV

show that holding a board seat and syndicating with local VC firms are alternative channels in which the VC firms can positively moderate the negative effect of historical military conflict on cross-border performance. In terms of economic significance, historical military conflict leads to a negative 6% IRR in the absence of a board seat, while the presence of a board seat leads to a positive 2% IRR. Similarly, syndication with local VC firms leads to a positive 9.5% annual IRR.

We use PME as an additional performance measure in Table 3, which compares cross-border performance to public market indices. Our method of estimating PME is similar to Kaplan and Schoar (2005), but we measure the performance at a deal rather than at fund level. The results of Table 3 show that the effect of historical military conflict on cross-border performance is robust using PME. However, high political affinity, holding a board seat and syndicating with local VC firms all moderate the negative effect of historical military conflict on performance. In terms of economic significance, a one standard deviation increase in historical military conflict decreases the PME by 3%, to 7%. This evidence is statistically and economically significant. Overall, our results are consistent with the findings of previous studies (e.g. C. Li *et al.*, 2020). The negative effect of historical military conflict on IRR or PME is stronger than that reported for cross-border M&A. Possibly, the difference is due to different performance measures (i.e. IRR or PME vs cumulative abnormal returns).<sup>9</sup>

Table 4 shows the results for the cross-border performance as measured by IRR. Model I shows the effect of historical military conflict on IRR, controlling for distance-specific and VC firm characteristics, industry, country and financing stage fixed effects. Model II shows the effects of historical military conflict on IRR, controlling for all characteristics.

Historical military conflict consistently has a negative effect on IRR. In terms of economic significance, a one standard deviation increase in historical military conflict decreases the IRR by 7%, to 3%, consistent with H1. It is worthwhile noting that the effect of military conflict on cross-border performance is statistically significant when controlling for distance characteristics. VC age, fund age, investment size, investment duration, market liquidity and syndication all have a positive effect on cross-border performance, consistent with previous studies (Buchner *et al.*, 2018; Y. Li, Vertinsky and Li, 2014; L. Wang and Wang, 2012). Stated differently, experienced VC firms, mature funds, large investment, long-term investment, higher liquidity and syndication partnership all enhance cross-border performance. The post-1997 indica-

tor has a negative effect on performance, owing to the bursting of the dot-com bubble after the late 1990s, in line with previous evidence (Buchner *et al.*, 2018). Together, the results show that a one standard deviation increase in historical military conflict decreases the IRR between 5% and 9% in the absence of syndication, board seat and high political affinity between the countries of the portfolio company and VC firm.

The last three models in Table 4 and Figure 1<sup>10</sup> test H2–H4. These results show the moderating effects of high political affinity, board seat and syndication on the historical military conflict–IRR relationship. The moderating effect of high political affinity on the relationship between historical military conflict and VC performance is positive (Figure 1a). A high degree of political affinity helps the VC firm to overcome animosity and attenuate the negative effect of prior military conflict on cross-border performance, consistent with H2. H3 suggests that having a board seat attenuates the historical military conflict–IRR relationship. In line with our expectation, we find that a board seat has a positive moderating effect (Figure 1b). This result shows that a board seat on the VC firm's portfolio company can mitigate the negative effect (Gabrielsson and Huse, 2002) of historical military conflict on cross-border performance. In other words, a one standard deviation increase in historical military conflict increases the performance by 2%, from negative 7%, when political affinity is high and the VC firm holds a board seat.

Regarding our hypothesis on syndications with diverse partners, the moderating effect of syndication on the historical military conflict–IRR relationship is positive, while the direct effect of the syndication on IRR is large and positive. This is equivalent to a 2.3% increase, from negative 9%, in the absence of syndication. However, we cannot make the claim that syndication offsets the negative effect of historical military conflict on the IRR, per se. Figure 1c shows the different effects of historical military conflict on IRR between investments with and without VC firm syndications. It is evident that syndication is beneficial and leads to higher predicted VC performance, while the overall interaction is negative. It appears that the benefits of VC syndication decline when historical military conflict is extremely high. In sum, while

<sup>9</sup>Since distance variables might be highly correlated, we compute the variance inflation factor and find that it has a value of 2.7, suggesting that multicollinearity is not a concern.

<sup>10</sup>We find similar results for the interaction graphs using PME; these are available upon request.

Table 4. Multivariate analysis setting examining the effect of historical military conflict on VC performance (IRR). This table considers the effect of the variables of interest on VC performance. The dependent variable is the IRR. The coefficients represent the effect of a unit change on the IRR, given that all other variables are held constant. The p-value for this statistic is reported in parentheses. The independent variables are categorized into distance and control variables, including fixed effects. The interaction terms represent the multiplication of the historical military conflict with the dummy of (i) high political affinity, (ii) board seat and (iii) syndication

Variables	Model I		Model II		Model III		Model IV		Model V	
	Coef.	p-Val	Coef.	p-Val	Coef.	p-Val	Coef.	p-Val	Coef.	p-Val
IRR (dependent variable)										
Historical military conflict × High political affinity			0.030	(0.01)						
Historical military conflict × Board seat			0.020	(0.02)						
Historical military conflict × Syndication									0.140	(0.03)
<b>Distance and friction characteristics</b>										
Historical military conflict	-0.040	(0.00)	-0.070	(0.00)	-0.130	(0.00)	-0.070	(0.03)	-0.070	(0.04)
Political affinity			0.070	(0.02)			0.152	(0.00)	0.152	(0.00)
High political affinity (dummy)			0.001	(0.10)	0.052	(0.02)	0.001	(0.77)	0.001	(0.30)
Geographical distance	0.000	(0.42)	0.002	(0.10)	0.001	(0.81)	0.001	(0.81)	0.005	(0.03)
Cultural distance	0.002	(0.14)	0.023	(0.14)	0.012	(0.30)	0.062	(0.01)	0.062	(0.01)
Regulatory distance	0.013	(0.24)	-0.029	(0.02)	-0.026	(0.01)	-0.029	(0.13)	-0.03	(0.12)
Political stability distance	-0.025	(0.01)	-0.016	(0.28)	-0.001	(0.94)	-0.049	(0.03)	-0.048	(0.04)
Legal system	-0.001	(0.95)	-0.001	(0.98)	0.005	(0.88)	-0.183	(0.00)	-0.182	(0.00)
Government fractionalization index	-0.022	(0.48)								
<b>Control variables</b>										
VC age	0.015	(0.03)	0.015	(0.03)	0.014	(0.04)	0.032	(0.01)	0.031	(0.02)
Fund age	0.041	(0.00)	0.040	(0.00)	0.039	(0.00)	0.126	(0.00)	0.125	(0.00)
Investment size	0.014	(0.00)	0.014	(0.01)	0.014	(0.00)	0.038	(0.00)	0.037	(0.00)
Investment duration	0.007	(0.00)	0.007	(0.00)	0.008	(0.00)	0.036	(0.00)	0.036	(0.00)
Stock market LiQ	0.001	(0.00)	0.001	(0.00)	0.001	(0.00)	0.001	(0.00)	0.001	(0.00)
Post-1997	-0.091	(0.00)	-0.112	(0.00)	-0.101	(0.00)	-0.049	(0.01)	-0.052	(0.08)
Syndication	0.019	(0.09)	0.025	(0.05)	0.020	(0.07)	0.020	(0.06)	0.033	(0.06)
Board seat							-0.020	(0.41)		
<b>Fixed effects</b>										
FE – Industry	Y		Y		Y		Y		Y	
FE – Country	Y		Y		Y		Y		Y	
FE – Stage finance	Y		Y		Y		Y		Y	
Adj. R-squared	0.102		0.110		0.109		0.101		0.092	
N	3746		3746		3746		3746		3746	

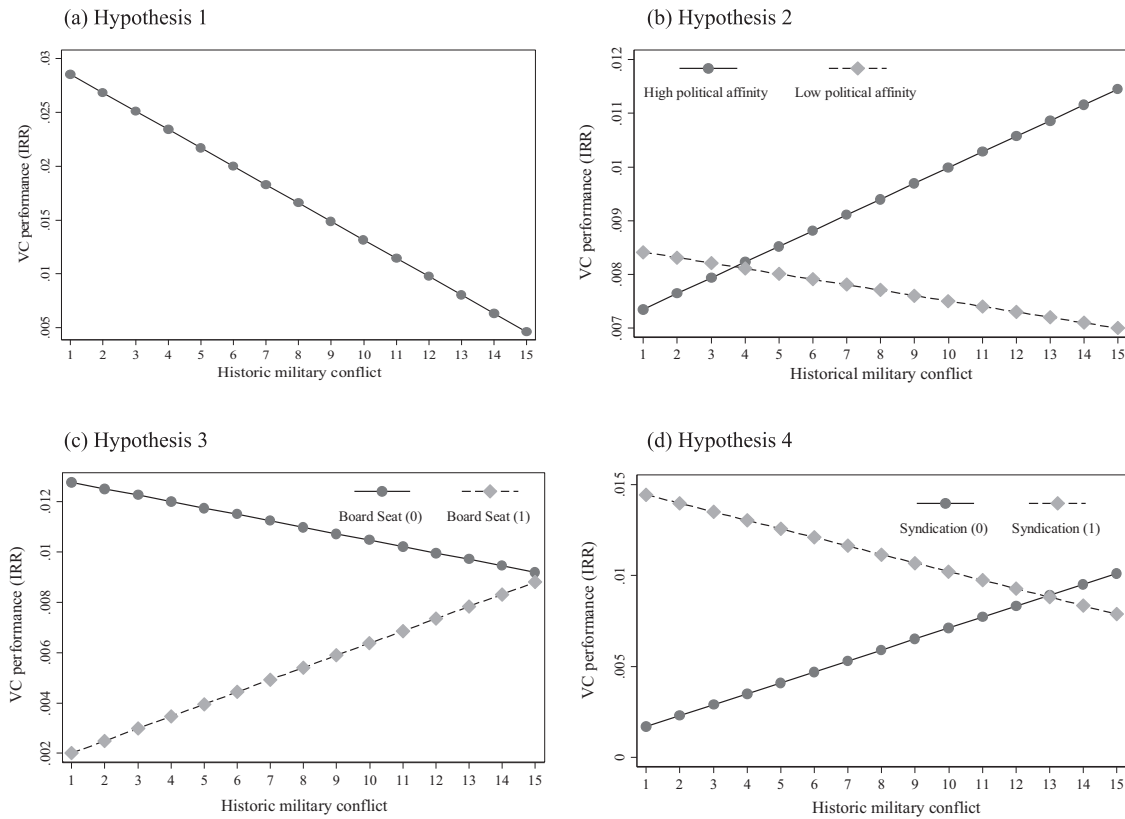


Figure 1. Illustration of moderating effects

syndication boosts cross-border performance in home countries of lower historical military conflict (Table 4), it accentuates the negative relationship between higher historical military conflict and IRR (Figure 1c).

In Table 5, we use the PME as an alternative measure of performance instead of the IRR. The results are largely consistent with the results reported in Table 4. It is evident from Table 5 that historical military conflict has a negative effect on PME. Overall, the results show that historical military conflict has a significant effect on cross-border investments. It is also evident that the negative effect of historical military conflict is less when the VC firms syndicate, hold a board seat or there is better political affinity between the countries of VC and portfolio companies.

*Additional analyses and robustness tests*

We execute additional analyses in Table 6. We examine whether the results are influenced by year fixed effects and find that our results are ro-

bust, controlling for year fixed effects as shown in Table 6, Model I, Panel A. It is possible that entry barrier might have an impact on the likelihood of cross-border in addition to other macro variables. In Model II, we use the FDI restrictiveness index as a proxy for entry barrier, collected from the OECD database. We find that in the first stage of the Heckman model, the FDI restrictiveness index negatively influences the likelihood of cross-border investments. Nevertheless, our second-stage base-line results remain robust. Similarly, religion differences between VC firms and portfolio companies and past performance are likely to affect cross-border performance. We collected the main religion between the home and host countries of the VC firms from CIA World Factbook. We followed Chircop, Johan and Tarsalewska (2020) and Di Pietro and Masciarelli (2022) to compute religion differences between the countries of VC firms and portfolio companies. We control for religion differences in our analysis and past performance (Table 6, Models III and IV, Panel A), respectively. Our results show that

Table 5. Multivariate analysis setting examining the effect of historical military conflict on VC performance (PME). This table considers the effect of the variables of interest on VC performance. The coefficients represent the effect of a unit change on PME, given that all other variables are held constant. The p-value for this statistic is reported in parentheses. The independent variables are categorized into distance and control variables, including fixed effects. The interaction terms represent the multiplication of the historical military conflict with the dummy of (i) high political affinity, (ii) board seat and (iii) syndication

Variables	Model I		Model II		Model III		Model IV		Model V	
	Coef.	p-Val	Coef.	p-Val	Coef.	p-Val	Coef.	p-Val	Coef.	p-Val
PME (dependent variable)										
Historical military conflict × Political affinity			0.020	(0.00)						
Historical military conflict × Board seat			0.030	(0.04)						
Historical military conflict × Syndication							0.020	(0.07)		
<b>Historical military conflict</b>										
Political affinity	-0.020	(0.68)	-0.080	(0.04)	-0.280	(0.00)	-0.060	(0.02)	-0.050	(0.031)
High political affinity (dummy)	0.001	(0.61)	0.001	(0.15)	0.079	(0.04)	0.129	(0.03)	0.134	(0.02)
Geographical distance	0.002	(0.60)	0.005	(0.06)	0.001	(0.62)	0.001	(0.38)	0.001	(0.35)
Cultural distance	0.108	(0.00)	0.076	(0.01)	0.070	(0.00)	0.047	(0.02)	0.007	(0.02)
Regulatory distance	-0.061	(0.03)	-0.026	(0.27)	-0.016	(0.41)	-0.008	(0.72)	-0.007	(0.76)
Political stability distance	-0.006	(0.88)	-0.033	(0.24)	-0.019	(0.47)	-0.03	(0.28)	-0.029	(0.30)
Legal system	-0.035	(0.70)	-0.094	(0.24)	0.019	(0.77)	0.138	(0.08)	0.137	(0.08)
Government fractionalization index										
Control variables										
VC age	0.082	(0.00)	0.048	(0.00)	0.031	(0.03)	0.025	(0.10)	0.026	(0.10)
Fund age	0.088	(0.00)	0.121	(0.00)	0.096	(0.00)	0.128	(0.00)	0.128	(0.00)
Investment size	0.054	(0.00)	0.052	(0.00)	0.054	(0.00)	0.055	(0.00)	0.055	(0.00)
Investment duration	0.013	(0.03)	0.014	(0.00)	-0.022	(0.00)	-0.017	(0.00)	-0.017	(0.00)
Stock market LiQ	0.001	(0.00)	0.001	(0.01)	-0.000	(0.01)	-0.001	(0.00)	-0.001	(0.00)
Post-1997	-0.086	(0.07)	0.057	(0.12)	-0.073	(0.03)	-0.135	(0.00)	-0.136	(0.00)
Syndication	0.037	(0.26)	0.028	(0.27)	0.026	(0.06)	0.040	(0.07)	0.044	(0.07)
Board seat							-0.007	(0.82)		
Fixed effect										
FE – Industry	Y		Y		Y		Y		Y	
FE – Country	Y		Y		Y		Y		Y	
FE – Stage finance	Y		Y		Y		Y		Y	
Adj. R-squared	0.121		0.104		0.109		0.105		0.103	
N	3746		3746		3746		3746		3746	



Table 6. Multivariate analysis setting examining the effect of historical military conflict on VC performance (IRR) with alternative specifications. The table reports the second stage considering the realized cross-border VC investments and the effect of the variables of interest on VC performance. The first-stage models are similar to that reported in Table 2. This table considers the effect of the variables of interest on VC performance. The dependent variable is the IRR. The coefficients represent the effect of a unit change on the IRR, given that all other variables are held constant. Panel A shows the results for additional variables and Panel B shows the interacted results. The interaction terms represent the multiplication of the historical military conflict with the dummy of (i) local syndication, (ii) syndication, (iii) high country-specific experience, (iv) high international experience and (v) high cooperation events. The p-value for this statistic is reported in parentheses. The independent variables are categorized into distance and control variables, including fixed effects

Panel A	IRR (dependent variable)	Model I: Fixed effect		Model II: Restrictiveness		Model III: Religion effect		Model IV: Past performance	
		Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val
Distance and friction characteristics	<b>Historical military conflict</b>	-0.049	(0.04)	-0.113	(0.02)	-0.103	(0.02)	-0.104	(0.01)
	Political affinity	0.055	(0.00)	0.148	(0.00)	0.148	(0.00)	0.146	(0.00)
	Geographical distance	0.000	(0.01)	0.001	(0.12)	0.001	(0.12)	0.001	(0.12)
	Cultural distance	0.008	(0.06)	0.004	(0.08)	0.004	(0.08)	0.004	(0.08)
	Regulatory distance	0.072	(0.03)	0.048	(0.03)	0.048	(0.03)	0.048	(0.03)
	Political stability distance	-0.036	(0.03)	-0.020	(0.07)	-0.020	(0.07)	-0.023	(0.06)
	Legal system	-0.041	(0.06)	-0.037	(0.02)	-0.037	(0.02)	-0.037	(0.02)
	Government fractionalization index	-0.104	(0.09)	-0.155	(0.021)	-0.155	(0.021)	-0.156	(0.021)
	Religion difference					-0.005	(0.09)		
	Trade openness (host)	0.003	(0.06)	0.001	(0.31)	0.001	(0.31)	0.001	(0.31)
Control variables	VC age	0.034	(0.04)	0.023	(0.04)	0.023	(0.04)	0.023	(0.04)
	Fund age	0.139	(0.00)	0.087	(0.00)	0.087	(0.00)	0.087	(0.00)
	Past performance							0.061	(0.02)
	Investment size	0.054	(0.00)	0.035	(0.01)	0.035	(0.01)	0.035	(0.01)
	Investment duration	0.018	(0.00)	0.027	(0.00)	0.027	(0.00)	0.027	(0.00)
	Stock market LIQ	0.001	(0.07)	0.001	(0.00)	0.001	(0.00)	0.001	(0.00)
	Post-1997			-0.038	(0.03)	-0.038	(0.03)	-0.038	(0.03)
	Syndication	0.033	(0.03)	0.017	(0.00)	0.017	(0.00)	0.017	(0.00)
	Board seat	-0.029	(0.04)	-0.029	(0.04)	-0.029	(0.04)	-0.029	(0.04)
	Inverse Mills I	0.014	(0.15)	0.016	(0.14)	0.016	(0.14)	0.008	(0.15)
	Inverse Mills II	0.018	(0.25)	0.019	(0.16)	0.019	(0.16)	0.011	(0.19)
Fixed effects	FE - Industry	Y		Y		Y		Y	
	FE - Country	Y		Y		Y		Y	
	FE - Stage finance	Y		Y		Y		Y	
	FE - Year	Y		N		N		N	
	Adj. R-squared	0.121		0.101		0.102		0.104	
	N	3746		3746		3746		3746	

Table 6. (Continued)

Panel B	IRR (dependent variable)	Model I		Model II		Model III		Model IV		
		Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val	Coeff.	p-Val	
	Historical military conflict × Local syndication	0.142	(0.03)							
	Historical military conflict × High country-specific experience			0.047	(0.02)					
	High country-specific experience			0.091	(0.01)					
	Historical military conflict × High international experience					0.031	(0.03)			
	High international experience					0.072	(0.01)			
	Historical military conflict × High cooperation event							0.033	(0.03)	
	High cooperation event							0.028	(0.00)	
	<b>Historical military conflict</b>									
Distance and friction characteristics	Political affinity	-0.075	(0.04)	-0.063	(0.02)	-0.072	(0.02)	-0.105	(0.00)	
	Geographical distance	0.139	(0.02)	0.131	(0.01)	0.145	(0.00)			
	Cultural distance	0.002	(0.15)	0.001	(0.12)	0.001	(0.12)	0.001	(0.14)	
	Regulatory distance	0.011	(0.06)	0.004	(0.06)	0.004	(0.08)	0.002	(0.20)	
	Political stability distance	0.045	(0.03)	0.046	(0.03)	0.049	(0.03)	0.013	(0.26)	
	Legal system	-0.021	(0.08)	-0.021	(0.07)	-0.020	(0.07)	-0.046	(0.01)	
	Government fractionalization index	-0.035	(0.02)	-0.037	(0.02)	-0.036	(0.02)	-0.014	(0.27)	
	Trade openness (host)	-0.159	(0.03)	-0.155	(0.02)	-0.154	(0.03)	0.016	(0.15)	
			0.002	(0.33)	0.002	(0.22)	0.001	(0.31)	0.003	(0.19)
			0.023	(0.03)	0.025	(0.03)	0.024	(0.03)	0.018	(0.02)
Control variables	VC age	0.082	(0.00)	0.087	(0.00)	0.085	(0.00)	0.04	(0.00)	
	Fund age	0.031	(0.04)	0.035	(0.01)	0.035	(0.01)	0.014	(0.00)	
	Investment size	0.027	(0.00)	0.027	(0.00)	0.027	(0.00)	0.018	(0.00)	
	Stock market LIQ	0.001	(0.02)	0.001	(0.00)	0.001	(0.00)	0.001	(0.00)	
	Post-1997	-0.039	(0.023)	-0.039	(0.03)	-0.039	(0.03)	-0.091	(0.00)	
	Local syndication	0.048	(0.00)							
	Syndication			0.019	(0.00)	0.017	(0.00)	0.039	(0.02)	
	Board seat	-0.026	(0.03)	-0.026	(0.03)	-0.029	(0.04)			
	Inverse Mills I	0.016	(0.15)	0.012	(0.18)	0.010	(0.17)	0.011	(0.22)	
	Inverse Mills II	0.017	(0.18)	0.017	(0.22)	0.015	(0.18)	0.016	(0.14)	
Fixed effects	FE – Industry	Y		Y		Y		Y		
	FE – Country	Y		Y		Y		Y		
	FE – Stage finance	Y		Y		Y		Y		
	Adj. R-squared	0.112		0.114		0.102		0.098		
	N	3746		3746		3746		3746		

the negative impact of historical military conflict is consistent with our baseline results, controlling for religion differences or past performance.<sup>11</sup>

Arguably, syndication in which the lead VC is local would have a different moderating effect compared to syndication where the lead VC is foreign. The local syndication dummy is one when the lead VC is local, and zero otherwise (Hopp and Rieder, 2011; Tykvová and Schertler, 2014). Similarly, the moderating effect of the syndication might not be stronger when historical military conflict is high between the home country of the VC and the host country of the portfolio company. The results of Table 6, Models I and II, Panel B show a strong moderating effect of syndication in which the lead VC is local.<sup>12</sup> We also examine the moderating effects of VC experience by separating into (i) country-specific experience (Model II) and (ii) international experience (Model III). Our results show that the moderating effect of VC experience is relatively stronger when it is country-specific than international experience. Finally, in Model IV, we use cooperation events as an alternative measure of political affinity, similar to D. Wang *et al.* (2021). We find that high cooperation events mitigate the negative effect of historical military conflict.<sup>13</sup>

Given that VC firms in cross-border investments are involved with their portfolio companies over time, the time to exit is critical for VC firms. We use the exit rate (i.e. inverse of time to exit) as an alternative measure of VC performance, consistent with previous studies (Espenlaub, Khurshed and Mohamed, 2015; Giot and Schwienbacher, 2007). The exit rate is measured as the inverse length of time from the investment date in a given portfolio company to the exit date. We examine how historical military conflict between countries influences exit rates, controlling for macro factors and VC deal characteristics. The results of the Cox models are reported in Table OA.5. The coefficient of historical military conflict for the base-line result is positive and suggests that the exit rate is higher when the conflict is high.

<sup>11</sup>We thank an anonymous reviewer for suggesting the inclusion of religious difference as an additional important variable in explaining the relationship between historical military conflict and cross-border performance.

<sup>12</sup>We thank the reviewers for suggesting this test.

<sup>13</sup>Our results are robust using PME instead of IRR as a measure of performance.

We use the yearly measure of militarized interstate disputes at a given year instead of accumulation of previous military conflicts. The results in Table OA.6 show that cross-border performance is negatively related to a military conflict indicator. In fact, the IRR is lower by 15–17% compared to countries with no military conflict. This is consistent with our base-line results reported in Tables 4 and 5.

Furthermore, we investigate the effect of historical military conflict by region and find that its effect is stronger for North America than other regions. We also find that the effect of historical military conflict is not symmetric, but marginally different across the regions. These results are reported in Tables OA.7 and OA.8.

## Discussion and conclusions

Prior studies suggested that the quality of interaction between VC firms and portfolio companies is crucial to maximize the returns for VC firms (Espenlaub, Khurshed and Mohamed, 2015; Giot and Schwienbacher, 2007; Gompers and Lerner, 2001; Jääskeläinen, Maula and Seppä, 2006; Sapienza, Manigart and Vermeir, 1996; Sethuram, Taussig and Gaur, 2021). Nonetheless, relatively limited attention has been paid to explaining its source. To address this opportunity, we draw on the international relations perspective and intergroup relations theory to identify historical military conflict as a novel source shaping the quality of interactions between VC firms and portfolio companies. Further, we theorize the presence of interrelationships among historical military conflict, political affinity, VC board seat, syndication and VC performance. Specifically, we argue that political affinity and VC board seat mitigate the negative effect of historical military conflict on performance, whereas syndication accentuates the negative effect of historical military conflict on cross-border performance.

Our conceptual framework provides several theoretical contributions and implications. First, our study provides a more balanced view of entrepreneur–VC relationships by proposing a new source of uncooperative and opportunistic attitudes between VC firms and portfolio companies during the holding period. Specifically, we identify historical military conflict as a source of intergroup tensions and mistrust, influencing the

quality of interactions during the holding period and VC performance. In fact, our analysis shows that the explanatory power of historical military conflict on cross-border VC performance is stronger than political affinity, cultural, geographical and regulatory distances. We show that these opportunistic behaviours, triggered by historical military conflict, can cause tensions between VC firms and portfolio companies.

Second, our contingency approach of investigating the inter-relationships among historical military conflict, political affinity, VC board seat, syndication and VC performance provides a basis for understanding the control, collaboration and performance of cross-border investments (Felin and Foss, 2005; Foss and Pederson, 2019; Raisch, Hargrave and Van De Ven, 2018). In particular, our study considers not only the board seat variable to explain how more control can help VC firms protect their interests, but also syndication to understand how collaborative efforts can prevent VC firms from effectively governing portfolio companies. The latter point is an interesting finding, given that most prior studies focus on the benefits of syndication, with scant attention on how VC consortia can lead to discordance between VC firms and heighten the pressure between VC and portfolio companies. Thus, these complementary perspectives on different ownership control strategies provide a more nuanced understanding of the core relationship.

We also offer important lessons for VC firms, entrepreneurs and investors willing to engage in cross-border investments. It is imperative that the historical development of international relations between the home countries of VC firms and their portfolio companies should be closely monitored to appropriately mitigate any financial risk stemming from the investment holding periods. VC firms interact closely with portfolio companies during the holding period and subsequently exit their investments, which differs from cross-border acquisition. In addition, while VC firms are known to evaluate the businesses and financials of the portfolio companies, consideration of various institutional factors shaping the quality of intergroup relations may have been partly overlooked. Given that VC firms commit capital for several years, implying frequent intergroup interactions, it is crucial for VC firms to understand how to mitigate intergroup tensions and opportunism. As evidenced from our analysis, taking a board seat is a

useful measure to mitigate the negative effect on returns for cross-border deals between countries with historical military conflict. This is in line with the ownership control strategy implemented by the Japanese VC Softbank, one of the largest shareholders of the Chinese e-commerce company Alibaba. Furthermore, our results show that syndication with diverse partners is ineffective at managing the animosity between countries when that animosity becomes extremely high. The above recommendations for VC firm managers could be used in due diligence and during the holding period to mitigate intergroup-related problems. From the portfolio company's perspective, the results indicate the importance of awareness of a collective memory and how this may affect the day-to-day interactions with VC sponsors in a cross-border setting. Finally, our study shows that the importance of international relations for the success of cross-border VC investments can be extended to a variety of entrepreneurial finance and international investment settings.

#### *Future research opportunities*

Our study has some limitations that provide opportunities for future research. We acknowledge the limitation of the historical military conflict measure because of the fact that it does not fully consider the sentiment or perceptions of individual managers. Future studies employing micro-level measures (e.g. how managers of VC firms and portfolio companies perceive other countries) could capture the effect better, and we leave these for future research. Nevertheless, country-level dyadic measures are widely used measures of international business research, which is fundamentally about 'understanding how country-level context relates to individual and firm behaviour' (Beugelsdijk, Kostova and Roth, 2017, p. 31).

It is worth noting that the context of cross-border VC investments is peculiar, because the investments are mostly aimed at guiding and nurturing the growth of start-up firms. Hence, the interactions between VC firms and portfolio companies are closer than targets and acquirers in cross-border acquisitions. Moreover, cross-border acquisitions tend to take place between incumbent firms as acquirers and target companies, where the role of coaching and close monitoring is less demanding. Although historical military conflict could influence the performance of cross-border

acquisitions, it is not clear whether the effect of historical military conflict is stronger or weaker in VC cross-border investments where VC firms interact closely with their portfolio companies.

Finally, VC firms often collaborate with universities and research institutions, or come from specific universities and research institutions; such educational ties can foster trust and facilitate cross-border investment decisions (Bianchini and Croce, 2022; Fuchs *et al.*, 2022). Hence, a promising line of inquiry would be to investigate how educational ties influence cross-border investment decisions and performance.

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Axel Buchner is Full Professor of Finance at ESCP Business School (Berlin Campus). He conducts research in the areas of entrepreneurial finance, venture capital and private equity. He focuses on understanding the risks, returns and illiquidity inherent in venture capital, private equity and other alternative investments. His research papers are published in journals such as *Management Science*, *Journal of International Business Studies*, *Journal of Business Venturing* and *Journal of Corporate Finance*, among others.

Pia Helbing is Assistant Professor of Finance at the University of Edinburgh. She holds a MSc and PhD in Finance from Trinity College Dublin. Her work on initial public offerings, payout decisions, venture capital and private equity is published or forthcoming in journals including the *Journal of Corporate Finance* and *International Review of Financial Analysis*, among others.

Abdulkadir Mohamed is Professor of Accounting and Finance at Leeds Business School, University of Leeds, UK. His research focuses on private equity, venture capital, merger and acquisition, dividend policy and underwriters' compensations. He holds a MSc and PhD in Finance from Manchester Business School. His papers are published in journals including the *Journal of Corporate Finance*, *Journal of International Business Studies* and *Journal of Business Venturing*, among others.

Hyungseok (David) Yoon is Associate Professor of International Business at the University of Leeds. His research papers on international business, global innovation and entrepreneurship are published or forthcoming in journals including *Research Policy*, *British Journal of Management*, *International Business Review* and *Journal of Business Research*, among others.

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