Evaluation of Entrepreneurs on Indian Venture Capital Firms-A Study

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Abstract

Potential entrepreneurs rely on Venture Capital (VC) as an important source of finance not only for capital infusion but also for their value added services. Therefore, these entrepreneurs are often afraid to voice their real feelings about their VC partners. So studies on entrepreneur's perception of VC firms are useful in the sense that venture capitalists can adjust their behavior to improve their image among entrepreneurs. We have tried to assess the impact of age, fund size, and number of investment professionals on five dimensions of their VC firms. It appears that the VC firms are growing complacent with increase in their age. However, investment professionals and fund size of a venture capital firm have no bearing on the five dimensions.

*Key Words***:** Venture capital, entrepreneur relationship

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Introduction

Venture capital research is still a young research field. It was first in the early years of the 1990s the research field started to emerge Barry (1994). Mason and Harrison (1999) note that despite considerable efforts, there remains much that is unknown or inadequately understood about this market place. Gompers and Lerner (2000) opined that venture capital has grown from a cottage industry to an established financial service industry. Venture capital as a distinguishable financial service has become an increasingly important source of finance for new companies and plays a prominent role in the entrepreneurial process, financing the growth of knowledge based industries worldwide. Apart from finance, venture capitalists provide networking, management and marketing support as well as human capital. However, today the venture capital industry has globally matured and the organizational structure of venture capital companies growing more professional, hierarchical, and similar to that of other professional services organizations and with relatively less money from other institutions, the competition for investment capital has significantly increased. Thus, venture capitalists increasingly want to build and maintain the relationship with entrepreneurs and as well as with prospective investors not only to enhance their capital raising capabilities but also to convert professional and effective entrepreneur relationships as the source of new business referrals. However, in order to maintain relationships with their entrepreneurs, venture capital partners should know the perceptions of entrepreneur's and impressions they are carrying on their investment practices, as these perceptions could significantly affect the interaction and effectiveness of venture capital investment and finally the relationship between venture capitalists and entrepreneurs.

Perceptions of Indian start-ups on Indian venture capital firms

Yourstory.in, India's leading and most comprehensive online platform for startups and entrepreneurs, dedicated to promote the startup ecosystem, conducted a survey of Indian startups and tried to analyze how startups are perceiving Indian venture capitalists. The survey was conducted on Indian start-ups across the country (over 150 startups) in India. The survey results are summarized below. As may be seen from the table 1 below, startup entrepreneurs were asked to respond on the top three things that venture capitalists take into account before investing in a tech startup. 25.00% of the respondents said that the most important factor is size of the market the product is targeted. Pedigree of founders was a close second, with 22.00% of respondents. Strength of idea with 16.00% and product-market fit with 15.00% were the next two factors that entrepreneurs perceived were the most important criteria that venture capitalists used to make decisions for funding. It may also be noted that 15.00% of sample respondents opined that venture capital firms also consider previous experience of potential entrepreneurs while funding.

Table 1 Factors venture capitalists consider before investing in start-ups

Factors considered by venture capitalists	Size of the Market	Pedigree of Founders	Strength of Idea'	Product-Market fit	Previous experience	Founders References	Others	Total
(%)	25.00	22.00	16.00	15.00	15.00	4.00	3.00	100.00

(Source: www.yourstory.in)

Startups were asked about their perceptions on the advantages of venture capital investment, apart from the venture capital money from the investors. As may be seen from the table 2 below, start-ups have responded that contacts in the industry (22.00%) and increased visibility in the market (20.00%) were the top two factors that are most valuable and have biggest advantage for an entrepreneur with venture capital money. It may also be noted that 18.00% of start-ups opined that they have an advantage in mentorship opportunities.12.00% reported that there is a mileage on the venture capital firms brand image for a start-up venture.

Table 2 Perceptions of entrepreneurs on advantages of venture capital

Perceptions of entrepreneurs	Contacts in the industry	Mentorship Opportunities	Brand of the VC firm	Easier to sell/Acquire new customers	Easier to hire employees	Increased visibility in the industry	Total
(%)	22.00	18.00	12.00	11.00	17.00	20.00	100.00

(Source: www.yourstory.in)

Table 3 Perceptions of entrepreneurs on disadvantages of venture capital

Perceptions of entrepreneurs	Equity dilution	Loss of control/independence	Focus shifts to short-term goals	Pressure to create a big exit	Total
(%)	54.00	28.00	14.00	4.00	100.00

(Source: www.yourstory.in)

Startups were asked about their perceptions on the disadvantages of venture capital investment. As may be seen from the table 3, majority of sample entrepreneurs (54.00%) have responded that the biggest problem from venture capital funding is too much equity dilution. The other problems perceived by entrepreneurs on venture capital funding are loss of control/independence while running the company (28.00%), focus shifts to short-term goals (14.00%) and there is a pressure on start-ups to create a big exit (4.00%).

Review of Literature

A key component in the success of venture capital-backed firms is the relationship between the venture capitalist and the entrepreneur and these personal relationships help venture capitalists build reputation, and sourcing and winning deals. Kreps and Wilson (1982) argued that a firm’s reputation gives potential customers valuable information when making their purchase decisions, while offering important competitive advantages to more reputable firms. Prior research finds strong empirical evidence that reputation is a valuable asset, and this has led researchers to develop a number of theoretical models of reputation in the financial services industry. Timmons, Fast, and Bygrave (1983) noted the importance of venture capital for the establishment and growth of high technology companies, little attention has been given to how circumstances affect venture capital and entrepreneur relations. Tyebjee and Bruno (1984) documented how venture capital and entrepreneur relations affect the success of ventures. Heide et al. (1992) noted that making adjustments to accommodate the needs of the partner increases the fit between the two parties and thereby increases trust in the relationship. Amason and Schweiger (1992) argued that when entrepreneurs have access to venture capitalists expertise, effective interaction between the entrepreneur and the venture capitalist is necessary to realize its benefits and to ensure venture success. Ehrlich et al. (1994) note that entrepreneurs are not always seeking just money from venture capitalists but may also recognize the other benefits that they can derive from a positive, cooperative relationship with venture capital investors. He also argues that, who the entrepreneur gets his/her money from is just as important as how much capital is obtained initially. It is, however, not certain that a venture capitalist will actually deliver all or any potential non-financial benefits. Gompers (1995) view that venture capitalists reputation, their track record of taking portfolio companies to successful exits, and their network with other venture capitalists are important determinants for raising follow-on funds and accessing to high-quality deal opportunities. Research in this area suggests by Sapienza (1996) that procedural justice is an important determinant of investors' attitudes and behaviors and that it is positively associated with long-term venture performance. Busenitz et al. (1997) viewed that performance may be enhanced if the venture capitalist and entrepreneur relationship is fair. Cable and Shane (1997) also noted that post-investment and cooperation between external investors and entrepreneurs is crucial to the portfolio companies' success. Shepherd and

Zacharakis (2001) noted that venture capitalists and as well as entrepreneurs can build trust by engaging in frequent and open communication, signaling commitment and consistency, being fair and aligning the goals of the company. Busenitz et al. (2004) suggest that the relationship between venture capitalists and entrepreneurs may be well served by establishing procedures to ensure fairness and efficient information exchange. Valliere and Peterson (2004) noted that both entrepreneurs and venture capitalists are learning and adjusting their behavior as the industry emerges. Hsu (2004) note that entrepreneurs select offers among competing venture capital investors not only based on the financial terms, but more often by considering the reputation of the venture capital investors and also companies care about the identity of the investor, and when faced with multiple offers, companies are often in favor of more reputable investors and turn down less reputable ones even when they offer the best financial terms. Sorensen (2007) argues that there exists a positive sorting in the venture capital market, in that higher-quality companies are associated with more reputable venture capitalists. Krishnan (2009) studied the reputation of venture capital firms, and summarized that for specialized financial intermediaries that face a large number of competitors, reputation can be particularly important and reputation is particularly valuable not only to venture capitalists and their investors but also to potential portfolio firms that rely heavily on venture capital advisory services and risk capital for their survival and growth. Chapman (2009) reported that with reduced access to banks for capital, competition for venture capital funding has significantly increased and because of the increased competition for venture capital, it is important to understand what factors venture capitalists consider important for entrepreneurial success and to evaluate whether entrepreneurs hold a similar view. Krishnan et al. (2009) documented studies to show that entrepreneurs are aware of the benefits associated with venture capitalists reputation. Yavuz, Marquez, and Nanda (2010) note that fund managers may voluntarily limit fund size in order to match with high-quality entrepreneurial firms and consistently deliver superior returns. Given the importance of the matching in venture capital investments, how the relationship between venture capitalists and entrepreneurs evolve however is more or less neglected. Cumming and Na Dai (2011) argue that if reputable venture capitalists acquire negative new information regarding the potential of the company, they will stop investing in the company. Alternatively, while entrepreneurs learn positive new information regarding the quality of the company, they might pursue more reputable venture capitalists.

Yenfeng Zheng (2011) documented that entrepreneurs complain at least 400 times, on how these partners forget or delay to respond to their letters, emails, and or voice messages. Another notable pattern is that, this delay or non-responsiveness largely matters much to those entrepreneurs who like to know the outcome of their business ideas or plans. A symbolic phone call or e-mail seems to make a big difference in terms of maintaining a good image for venture capital firms. Large and Muegge (2008) documented that it has been well known by practitioners for decades that potential entrepreneurs rely on their venture capital investors for capital and other key resources. Therefore, entrepreneurs are often afraid to voice their real feeling about their venture capital investors. Their perception of venture capital firms is thus always masked or interpreted differently by dominant players or venture capital firms and our understanding regarding entrepreneurs perception of venture capital firms comes primarily from accounts from the venture capital side as memories of venture capitalists but not from entrepreneurs themselves. Hsu (2004) show that for a venture capital firm, a positive reputation among entrepreneurs would definitely help attract more deals, facilitate conversation, and ultimately create higher economic value. Haynes (2009) reported that an overwhelming majority of venture capital funds surveyed believe it is important for funds to have a strong brand and reputation, which is critical not just for deal flow, but also fund raising, recruiting, and investing. The New York Times (2012) documented that the business environment has changed from a decade ago, when entrepreneurs struggled to get noticed by venture capitalists flush with funds. These days, the tables have turned, and today, “the best entrepreneurs are courted by the venture capitalists.” Not many studies are available on the perception of entrepreneurs about their venture capital investors. Studies on entrepreneur’s perception of venture capital firms are useful in the sense that venture capital firms can adjust their behavior to improve their image among entrepreneurs and entrepreneur’s evaluation of their venture capital investors could form the basis for venture capitalists reputation among entrepreneurs. Economists and sociologists have recognized the importance of reputation in a market economy. Their basic assertion is that firms needed not only tangible resources and technology to operate, they also need to nurture and maintain their reputation among key stakeholders. Therefore, it may be said that the ultimate success of a venture capital firm rests with the talents, skills and knowledge of venture capital partners demonstration as evidenced in their investment ability by their entrepreneurs and if entrepreneurs or venture teams are not satisfied by venture capital partners investment practices and processes, it may play a big part in discouraging entrepreneurial activity. Therefore, venture capital companies should know and understand the information requirements and perceptions of their entrepreneurs.

Objectives and Methodology

The broader objective of the present study is to explore entrepreneurs’ perceptions of Indian venture capital firms. Some of the studies attempting to explore entrepreneurs’ perceptions of venture capital firms are based on the data available in the website, namely TheFunded.com.

TheFunded.com is an online community of over 18,000 CEOs, founders and entrepreneurs to discuss fund raising, rate and review investors, and discuss strategies to grow a start-up business. It is an online venture capital evaluation website founded by Adeo Ressi, an entrepreneur, in late 2006 and acknowledges that the motivation to start this was to share opinions about venture capital firms among his friends. However, the website received unexpectedly wide acceptance among the entrepreneurial community. The website provides data on venture capital firms operating internationally. Pavlou and Dimoka (2006) documented that online evaluation is becoming a popular tool for organizations to gather feedback from their customers, employees and or other stakeholders and decision makers often use the feedback to make improvements. In the venture capital industry, the emergence and growth of online feedback from sources such as TheFunded.com is reflective of this trend toward more open communication and evaluation.

Ours is a pilot study from the available online source, we have collected the data relating to Indian entrepreneurs who are funded by Indian venture capital firms. The data relating to the perceptions of entrepreneurs was collected in the month of February 2013 from the website. The website provides data on five dimensions. The numerical ratings (on a scale 5) on the five dimensions are track record denoted here as Y1, operating competence (Y2), pitching efficiency (Y3), favorable deal terms (Y4), and execution assistance (Y5). These data are available only for about twelve venture capital firms operating in India. We used these Indian data pertaining to entrepreneurs' perception about venture capital firms that have been funded by them. It may noted that, thirty-three entrepreneurs have given their perceptions on these Indian venture capital firms. It is believed that the use of these data will provide the feedback to the venture capital firms operating in India to make improvements in their approach to venture capital funding. Data thus collected were processed, analyzed and interpretated to draw valid inferences. For analyzing, the data and providing a statistical dimension to the study suitable statistical techniques were employed.

Results and Discussion

Table 4 Entrepreneurs rating on various dimensions of venture capital firms

VC firms	VCs Age (X1)	Investment professionals of VC firm (X2)	Fund Size in $ million (X3)	Track Record (Y1)	Operating Competence (Y2)	Pitching Efficiency (Y3)	Deal Terms (Y4)	Execution Assistance (Y5)
1	13	14	525	2.9	2.4	2.5	2.4	2.6
2	10	5	38	5	4	3	4	4
3	16	3	600	4	4	3	3.5	3
4	26	6	2500	0	0	0	4	1
5	7	6	60	2.4	3.2	2.2	2.5	3.5
6	7	9	180	2.7	3	3.8	3	3
7	14	8	500	0	0	0	4	1
8	25	51	350	0	0	0	4	1
9	8	8	135	5	5	4	3	1.5
10	6	7	200	4	4	3	0	0
11	11	15	325	0	0	0	4	1
12	7	7	105	2.8	3	3	3.7	3

(Source: The Funded.com, IVCA 2008 and 2011 and websites of venture capital firms)

Employing a regression model, we tried to study the impact of three independent variables on the five dimensions listed above. Data from TheFunded.com giving numerical ratings on five dimensions are used to study the perceptions of entrepreneurs on venture capital firms. These data are used in regressions. The independent variables chosen by us to study the perceptions are age of the venture capital firm (denoted as X1), number of investment professionals (X2), and the fund size (X3). We expect that with increase in age of the venture capital firm, its contribution (as noted by the five dimensions) to the success of the entrepreneurs will improve. Likewise, with increase in the number of investment professionals we expect them to contribute better for the success of the venture firm. Finally, fund size of the venture capital firm is also expected to aid the five dimensions considered here. The data on the ratings on the five dimensions listed above and the three independent variables chosen to explain the variations in the five dimensions are provided in the table 4 above. These data are used in linear regressions. As a first step, an attempt is made to study the impact of age of the venture capital firm on the five dimensions rated by entrepreneurs using simple linear regression equation. The results of this simple linear regression model are presented in tables 5.1 to 5.5.

Table 5.1 Influence of age of venture capital firm on track record- simple linear regression coefficient

Variable name	Regression Coefficient	t-value
Intercept	4.5601	4.47
Age	-0.172**	-2.39
R^2(with F-value)	0.3646	5.739**

**Significant at less than 5% level

Table 5.2 Influence of age of venture capital firm on operating competence- simple linear regression coefficient

Variable name	Regression Coefficient	t-value
Intercept	4.6624	5.0877
Age	-0.1823**	-2.8078
R^2(with F-value)	0.4408	7.884**

**Significant at less than 5% level

Table 5.3 Influence of age of venture capital firm on pitching efficiency- simple linear regression coefficient

Variable name	Regression Coefficient	t-value
Intercept	4.0501	5.4629
Age	-0.1606**	-3.0586
R^2(with F-value)	0.4833	9.355**

**Significant at less than 5% level

Table 5.4 Influence of age of venture capital firm on favorable deal terms-simple linear regression coefficient

Variable name	Regression Coefficient	t-value
Intercept	2.1228	3.2064
Age	0.0841***	1.7943
R^2(with F-value)	0.2435	3.219**

**Significant at 5% level, ***Significant at 10% level

Table 5.5 Influence of age of venture capital firm on execution assistance-simple linear regression coefficient

Variable name	Regression Coefficient	t-value
Intercept	2.8072	3.5755
Age	-0.0605	-1.0889
R^2(with F-value)	0.1060	1.1858

As may be seen from the above tables' age as a factor explaining the variations in the five dimensions of venture capital firms turned out to be having negative impact, except in the case of favorable deal terms. The regression coefficient of age of venture capital companies corresponding to the track record is negative and statistically significant at 5% level. It may be noted that, the coefficient is negative, that is the age of the venture capital firm surprisingly doesn't help the entrepreneur to rate the venture capital firms high in respect of their track record. Table 5.1 shows these regression results. Table 5.2 gives the regression results of the impact of the age of the venture capital firm on operating competence. The regression coefficient in this case is again negative and significant at less than 5% level. This is again a surprising result. Age of the venture capital firm is not helping the operating competence of venture capital firms to their entrepreneurs. Table 5.3 gives the regression results pertaining to the impact of age on pitching efficiency. The regression coefficient is again negative in this case and significant. Table 5.4 gives regression coefficient corresponding to the impact of age and favorable deal terms, the influence of age on favorable deal terms is not significant though it is positive in this case and not significant at usual 5% level. Next table 5.5 shows the regression coefficient corresponding to the impact of age of venture capital firm on execution assistance and it is again negative. But the coefficient is not significant at the 5% level. Based on the above analysis and tables showing the results relationship between age of the venture capital firm and the five dimensions of the entrepreneurs of venture capital firms, it can be highlighted that the age of the venture capital firm is generally not helping the venture capital firms to satisfy the entrepreneurs. This is a surprising result. The R^2 values in the above five regressions are reasonably high. Therefore, we cannot totally ignore our results. It seems that with increase in age of the venture capital firm, the firm is becoming complacent. They tend to take things for granted and not paying much attention to the entrepreneurs who are funded. The simple linear regression results showing the influence of number of investment professionals (X2) and the influence of fund size of the venture capital firm (X3) separately on the five dependent variables are not shown here, as the corresponding R^2 values are very low. However, we have attempted a multiple linear regression exercise with three independent variables. Before hand, we arrived at the correlation matrix with the variables on hand. (As may be seen from the table 6).

Table 6 Correlation matrix of the variables

	1	2	3	4	5	6	7	8
	Age (X1)	No of Investment professionals (X2)	Fund size (X3)	Track Record (Y1)	Operating Competence (Y2)	Pitching Efficiency (Y3)	Favorable Deal Terms (Y4)	Execution Assistance (Y5)
1	1							
2	0.526588	1						
3	0.731096	-0.0807	1					
4	-0.60386	-0.46748	-0.46667	1				
5	-0.66396	-0.49013	-0.49252	0.975939	1			
6	-0.69523	-0.46145	-0.49517	0.921508	0.949902	1		
7	0.493507	0.209702	0.253092	-0.43837	-0.49519	-0.45748	1	
8	-0.32559	-0.32459	-0.32547	0.470393	0.467801	0.513614	0.243815	1

The correlation matrix shows that there is multicolinearity between the variables X1 and X3 with r-value greater than (0.60). Therefore, we have dropped the variable X3 in the multiple regression equations. Thus, we have only two independent variables X1 and X3. The results of the regressions are presented in the tables 7.1 to 7.5 below. The results show that the value of R^2 increased with the addition of variable X2 in the regression equations and they are generally significant at less than 10% level. It may be observed that the independent variable age has significantly impacted on "operational competence" and "pitching efficiency". It has not had any influence on "track record" and "favorable deal terms" and "execution assistance". The sign of the age coefficient is generally negative and this is against what is postulated. Thus, we may conclude that our results are largely negative and the five dimensions of the venture capital firms are not influenced by age of the venture capital firm, number of investment professionals and fund size of the venture capital firm.

Table 7.1 Multiple linear regression coefficients of the factors influencing the track record

Variable name	Regression Coefficient	t-value
Intercept	4.53	4.32
Age	-0.14	-1.62
No of investment professionals	-0.31	-0.67
R^2(with F-value)	0.40	2.95***

***Significant at less than 10% level

Table 7.2 Multiple linear regression coefficients of the factors influencing the operating competence

Variable name	Regression Coefficient	t-value
Intercept	4.63	4.92
Age	-0.15***	-1.96
No of investment professionals	-0.02	-0.67
R^2(with F-value)	0.46	3.96**

**Significant at less than 5% level, ***Significant at less than 10% level

Table 7.3 Multiple linear regression coefficients of the factors influencing the pitching efficiency

Variable name	Regression Coefficient	t-value
Intercept	4.03	5.22
Age	-0.14**	-2.24
No of investment professionals	-0.01	-0.47
R^2(with F-value)	0.49	4.42**

**Significant at less than 5% level, ***Significant at less than 10% level

Table 7.4 Multiple linear regression coefficients of the factors influencing the favorable deal terms

Variable name	Regression Coefficient	t-value
Intercept	2.11	3.03
Age	0.09	1.55
No of investment professionals	-0.00	-0.20
R^2(with F-value)	0.24	1.47

Table 7.5 Multiple linear regression coefficients of the factors influencing the execution assistance

Variable name	Regression Coefficient	t-value
Intercept	2.79	3.43
Age	-0.03	-0.58
No of investment professionals	-0.02	-0.58
R^2(with F-value)	0.13	0.72

Conclusion

Entrepreneurs see venture capital as an important source of finance and associate it with increased growth in their businesses. However, when it comes to considering this source of finance, Indian entrepreneurs are also carrying indifferent perceptions around the nature of venture capital. Our results show that age of the venture capital firm has a negative impact on the dimensions such as “operating competence” and “pitching efficiency”, and it had no influence on the other three dimensions. It appears that the venture capital firms are growing complacent with increase in their age. Therefore, it can be said that, venture capitalists should focus on creating positive experience with their services, continuously show their commitment towards entrepreneurs while understanding their needs and should try to find creative ways of building intimacy, and aim at entrepreneur's satisfaction. These professional, personal, and effective relationships with potential entrepreneurs may help to improve their image and reputation among potential entrepreneurs and furthers sourcing and winning deals.

Limitations and scope for research

One of the limitations of this study is it comprises a relatively small number of entrepreneurs and venture capitalists. So a research direction could be one of extending the study by interviewing more entrepreneurs.

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