CHAPTER 3

OBJECTIVES OF THE STUDY AND HYPOTHESES

DEVELOPMENT

3.1 Objectives of the Study

The main aim of the research is to find out the role of venture capital in the overall development of IT sector in Indian scenario. Previous empirical literatures suggest that VC’s selection criteria is nearly very tough while selecting a firm for funding decision and because of this, they select very less business proposal for their investment decision. The present work aims at determining the key aspects of selection criteria opted by VC firms while selecting IT firms for their funding decision and also investigated the key investment objectives of VCs based on social, economical and financial aspects.

In the growth stage of IT industry in India, the unavailability of VC funding in IT sector has been observed. The investment nature of VC firms are quite different and they generally target high risky ventures which provides attractive returns on investment and for this they normally target a venture which is in startup stage. It has also been observed that VCs receive number of proposals every year but select very less business proposals for venture funding. This might be due to firms are unaware about the desires of VCs and so they are not able to make a sound business plan. The present study attempts to offer benefits to both, firms to make a sound business plan by involving the key factors that VCs consider while selecting a firm for funding decision and for VCs to evaluate a business proposal with their desired investment objectives.

The basic objective of the study is to provide a platform to new technology based startups who are looking for venture funding and to understand the quantitative and qualitative aspects of VC firms from their final decision point of view. In the process of designing an effective business plan, the study will be useful for IT firms in considering the key factors of VC’s selection process and to incorporate their key investment objectives.
IT industry has shown a progressive growth rate in the last few decades; hence this sector is contributing a significant role in the economic development of the economy. This study is a follow for previous studies but aims at VC’s investment decision for IT sector in Indian perspective.

The following are the main objectives:

i. To determine the key aspects of selection criteria opted by VCs during screening process of IT firms in Indian scenario.

ii. To investigate the key investment objectives of VCs based on social, economical & financial aspects with reference to selection of IT firms for VC funding decision.

iii. To analyze the relationship among the choice of factors taken by different investors and assignment of weights to each factor with respect to selection of IT firms in India scenario.

iv. To investigate the other significant dimensions of VC’s management team related to funding decision which are based on preferred field of investment, return on investment, types of compensations, commonly used financial instruments, exit plan mechanism, choice and pattern of investment.

3.2 Hypotheses Development

Hypothesis can be explained as an explanation which depends on certain known facts but still needs to be proved. In order to complete the investigation for a particular research or event, it is important to have an explanation which is to be accepted. A hypothesis has twofold effect; it may be correct or wrong.

3.2.1 Hypotheses Development on Determination of Selection Criteria of VCs

The selection of a firm for investment purpose depends upon multiple factors which are extensively analyzed by investors before making a final decision of investment. They consider numbers of key aspects which help them to decide whether to select a firm for venture funding or not, and even if a firm is selected than how much funding should be granted. Previous studies have investigated number of factors
of selection criteria opted by VCs while selecting a firm for investment decisions. Wells' (1974) determined the factors of selection criteria based on business proposal, product market, marketing and engineering skills. Poindexter (1976) focused on factors like quality of Management, expected rate of return, expected risk, management stake in the firm, financial provisions for investor’ rights, venture development stage, restrictive covenants, interest or dividend rate, present capitalization, investor control, and tax shelter considerations. However concern about technological risk and political risk about IT firms and any other sector was not incorporated.

Tyebjee and Bruno (1981 and 1984) investigated the factors like importance of market attractiveness, rate of return, managerial skills, stage of venture and size of investment. MacMillan, Siegel, and Subba Narasimha (1985) reviewed few important factors such as entrepreneur personality, entrepreneur experience, characteristic of product & services, market acceptance of the product, market characteristics & financial consideration and also reported certain risks associated with decision process such as management risk, product risk and financial risk.

MacMillan, Zemann and Subba Narasimha (1987) concluded the relevance of successful attributes of VCs as one of the important evaluation criteria to predict the venture. Khan (1987) determined factors like nature of product & investee’s desire. Sandberg (1987) emphasized on the relevance of track record as one of the key aspect of selection criteria.


Cumming & MacIntosh (2006), Brander et al. (2009) and Munari & Toschi (2010) also focused on economic development aspect for achieving high profit margin as one of the important aim of investment.

This study aimed at determining the most important factors while selecting IT firms for investment and to find out the relationship among the choice of factors and assignment of weights to each factor while selecting IT firms for investment decisions.
Factors determined under previous literature review have been incorporated in the present study to obtain the key selection criteria and key investment objectives of VCs in the selection of process of IT firms in Indian scenario. The difference in assignment of weights to each factor by different investors has also been observed during data collection. The identified factors and difference in assignment of weights to each factor motivated us to test two hypotheses for obtaining the role of venture capitalists, their investment pattern, selection criteria and key investment objectives during selection process of IT firms for funding decision.

We formed following hypotheses to determine the results for above objectives:

**Hypothesis 1:** All types of financial institutions choose the same factors while selecting IT firms for funding decision.

**Hypothesis 1a:** All types of financial institutions do not choose the same factors while selecting IT firms for funding decision.

**Hypothesis 2:** All the factors do not differ in terms of their assignment of weights across the different financial institutions.

**Hypothesis 2a:** All the factors differ in terms of their assignment of weights across the different financial institutions.

### 3.2.2 Hypotheses Development on Key Investment Objectives of VCs

Another objective is to determine the social, economical and financial objectives of VCs while selecting IT firms as an investment option and to study the relationship among choice of factors and assignment of weights to each factor by different investors. Available literature has shown that there are numbers of quantitative factors which are preferred by VC firms while making their funding decision.
We formed following hypothesis to obtain the results for this objective:

**Hypothesis 3:** All types of investors choose same social, economical and financial aspects for selecting IT firms as an investment option.

**Hypothesis 3a:** All types of investors do not choose same social, economical and financial aspects for selecting IT firms as an investment option.

**Hypothesis 4:** All types of investors do not differ in the assignment of weights to social, economical and financial factors during the screening process of IT firms.

**Hypothesis 4a:** All types of investors differ in the assignment of weights to social, economical and financial factors during the screening process of IT firms.