CHAPTER – III

REVIEW OF LITERATURE

3.1 Introduction

Review of literature is an important stage in the research studies; it provides foundation and basic knowledge of the research topic. It also helps the researcher to proceed further to identify, analyze and evaluate the need for the further development in the area of study. The purpose of the study, therefore, is reviewing the findings of earlier studies on Venture Capital, its role in promotion of knowledge based industries and its allied activities.

This chapter provides an overview of the existing literature with regard to the Venture Capital investment decision Process, rate of return and the selection criterion for Venture Capitalists. The review of literature helps to find out the existing gap.

Since the 1970s, academic researchers tried to explain and to get insight into the selection behavior of Venture Capitalists and this research domain has been intensively studied by scholars until the present. A distinction can be made between researchers who focus on the successive phases and the several activities in the decision-making process of Venture Capitalists on the one hand. And researchers who attempt to identify the criteria on which Venture Capitalists base their investment selection decisions on the other hand. Some studies focused on Venture Capitalists involvement and Measurement of return.

3.2 Literature on Venture Capitalists Evaluation Process

Wells (1974)\(^{10}\) addressed “Venture Capital Decisions making” in his research. He divided the activities that a VCs carries out into six categories. These stages are the search for investment opportunities, the screening of proposals, the evaluation of proposals, venture board meetings and follow-up, dealing with venture operations and finally the cashing out of the ventures.

Tyebjee and Bruno (1984) \(^{11}\) Pioneer study entitled “A model of VC investment activity” was adapted by Tyebjee and Bruno, although their study mainly focused on examining the VCs selection criteria, Tyebjee and Bruno (1984) modeled the investment activities of Venture Capitalists as a sequential process involving five steps. The first step is deal origination or how exactly deals enter into consideration as potential investments. The second step consists of a broad screening of the deals to limit investments to fields which the Venture Capitalist is familiar with. The next phase is the evaluation procedure during which proposals that passed through the screening are examined in a much more detailed way and where VCs subjectively judge the venture based on a multidimensional set of characteristics. The fourth step concerns deal structuring where the Venture Capitalist and the entrepreneur negotiate and have to agree on the investment in terms of amount, form and price. Eventually, the last step relates to post-investment activities which may vary from a rather passive role to close contact with the venture and active involvement in its day-to-day operations.

Silver (1985) \(^{12}\) in the research study entitled “Venture Capital”, “the complete guide for investors” he divided the activities into five categories; these stages are the search for opportunities, initial screening, due diligence, deal structuring, monitor progress and cash out process of venture funds. In a review of research into Venture Capitalists' Decision Making, Implications for Entrepreneurs, Venture Capitalists and Researchers, the observations made by the scholar (Edward Hudson and Michael Evans) in their study is highly relevant. This study was a perceptual done by silver. (Source: Hall & Hofer 1993, Table 2, Pp. 28)

Fried and Hisrich (1988) \(^{13}\) in their research article entitled “Venture Capital research: past, present and future” with some modifications, they conceptualized Tyebjee and Bruno’s model in their study. The steps in their model include: search for deals; screening of the proposed deals in terms of investment size, technology, market, location and stage of financing; comprehensive evaluation of screened deals in terms of return, risk, entrepreneur’s quality and experience, venture team etc.; deal structuring; performance monitoring and management assistance; exist of investment through public issue of the investee companies’ shares, acquisition by another company, or buy-back of shares by the investee company.

Hall (1989) in the research working paper study entitled “Venture Capital decision making and the entrepreneur”, researcher described the VCs decision process using eight successive stages, of which the first is the generation of a deal flow. The second stage is a brief proposal screening, followed by a more detailed assessment of the business plan. During the next step of project evaluation, the Venture Capitalist really visits the business and/or meets the entrepreneurial team. After that, the remaining investment proposals undergo due diligence. When an agreement is reached about the deal, the deal structuring stage takes place and venture operations start. The final phase encompasses the ending of the VC’s involvement in the new venture and is called the cash out stage.

Glosten and Muller (1990) in their research article entitled “Entrepreneurial Ability, Venture Investments, and Risk Sharing” they suggest a six stages model of the investment decision-making process starting with the investment proposal origination; the Venture Capital firm-specific screening; generic screening; first-phase evaluation; and closing (including deal structuring and negotiation).

Fried and Hisrich (1994) in their research article entitled “Towards a model of Venture Capital investment decision making” also modified the 1984 version of Tyebjee and Bruno and modeled the VC decision-making process as consisting of six stages: origination, VC firm-specific screen, first-phase evaluation, second-phase evaluation and closing.

Boocock and Woods (1997) in their research article entitled “The evaluation criteria used by Venture Capitalists: evidence from a UK venture fund” supported the prior models which suggest that the VC decision process comprises different successive stages. Their paper models the VC activities as generating a deal flow, initial screening, first meeting, second meeting, board presentation, due diligence, and finally the deal structuring stage. Additionally, their study found that the criteria may differ in their level of significance depending on the stage of the VC decision-making process.

Bliss (1999)\textsuperscript{18} in his research article entitled “A Venture Capital model for transitioning economies: the case of Poland,” Venture Capital was to extend the model of Fried and Hisrich (1994) to transitioning economies. Their VCs decision-making process differs in two important ways: variation in the deal origination stage and a lack of firm-specific screening.

Zutshi and others (1999)\textsuperscript{19} in their research article entitled “Singapore Venture Capitalists Investment Evaluation Criteria: A Re-Examination” used a mail survey methodology to study the investment evaluation criteria of 58 Venture Capitalists in Singapore using the five core criteria and an additional criterion – country risk, and found that Singapore Venture Capitalists use investment criteria similar to those of US, Canada and Europe.

Silva (2004)\textsuperscript{20} in his research article entitled “Venture Capitalists' decision-making in small equity markets: a case study using participant observation”, demonstrated that the VC investment process is characterized by more and earlier interaction between the VC and the entrepreneur(s) than in previous models. Contrary to the findings in prior literature, the research revealed that the several activities in the stages of the decision-making process arise simultaneously rather than consecutively. The stages involved are Deal origination, Informal screening, Formal screening, Evaluation, Closing.


3.3 Literature on Venture Capitalists Evaluation Criteria

Since VCs spend a lot of time and effort on the screening of business proposals, a second stream of empirical research on the Venture Capital decision-making process attempts to discover the criteria most commonly used by Venture Capitalists in assessing potential investments.

**Briskman (1966)**\(^{22}\) in his research study entitled “Venture Capital: The Decision to Finance Technically-Based Enterprises”, regarding decision to finance, by using ranking method, with one VC proposal shows that VCs decide to invest or not to invest in a venture on the basis of projected returns, followed by CEO, market, product.

**Wells (1974)** \(^{23}\) in his research article entitled “Venture Capital Decision Making” conducted personal interviews with eight Venture Capital companies. The criteria which his respondents used to evaluate business proposals and deals include an order of significance management commitment, product, market, marketing skill, engineering skill, marketing plan, financial skill, manufacturing skill, references, and other participants in the deal, industry/technology, and cash-out method.

**F.R. Driscoll (1974)** \(^{24}\) in his research article entitled “Venture Capital: The Risk-reward Business” has asserted that the role of the Venture Capitalist goes beyond mere provision of funds to the venture. He argued that the real challenge to Venture Capitalist lies in managing the risk of the venture.

**Poindexter (1976)** \(^{25}\) in his research article entitled “The Efficiency of Financial Markets: The Venture Capital Case,” added to Wells’ criteria (1974) and re-ranked them with a more extensive sample size of 97. The new criteria, with modified rankings according to their significance, include quality of management, expected rate of return, expected risk, percentage equity share of venture, Management stake in firm, financial provisions for investor rights, venture


development stage, restrictive covenants, and interest of dividend rate, present capitalization, investor control, and tax shelter considerations.

Tyebjee and Bruno (1981) in their study entitled “Venture Capital decision-making: Preliminary results from three empirical studies”, identified six dimensions by which Venture Capitalists characterize and assess entrepreneurial opportunities: profitability of the venture, market factors, management Quality, uncontrollable risks, cash-out factors (or exit-opportunities) and viability of the venture. They found management skills of the prospective entrepreneur to be the most influential determinant of a positive investment decision.

Tyebjee and Bruno (1984) in their study entitled “A Model of Venture Capitalist Investment Activity,” attempted to ascertain the factors, which influence the investment decisions of VCFs in the US. They found five categories of decision criteria: market attractiveness, product differentiation, managerial capabilities, environmental threat resistance, and cash-out potential. Using a linear regression model, the authors found that the perceived risk was influenced by managerial capabilities and the resistance to environmental threat while the expected return was strongly influenced by market attractiveness, followed by a highly differentiated product. Cash-out potential did not have any impact on the perceived risk and the expected return of a venture. VCs when confronted with these results disagreed (Tyebjee 1984). In particular, two significant variations were observed: a) That managerial quality has a much higher impact on the selection process and b) that the management quality considerably affects both expected return and risk.

MacMillan, Siegel and Subba Narashimha (1985) in their research article entitled “Criteria Used by Venture Capitalists to Evaluate New Venture Proposals”, in carried out a two-step study, interviewed of 14 VCs and identified 27 criteria of evaluating venture investment. Then they grouped these criteria in six groups: Entrepreneur’s personality, Entrepreneur’s experience, product characteristics, market characteristics, financial considerations and composition of venture team. They then


tested the model with a questionnaire mailed to a sample of 150 VCs in the US. The analysis revealed that, out of 10 criteria most frequently rated as essential, six related to the entrepreneur’s personality and experience.

Hutt and Thomas (1985)\textsuperscript{29} in their research article entitled “Venture Capital in Arizona” the management team’s previous track record is a key factor in the evaluation by VCs. Other important criteria resulting from their study are the degree of product differentiation and a profound understanding of market demand and level of competition.

Goslin and Barge (1986)\textsuperscript{30} in their research article entitled “Entrepreneurial Qualities Considered in Venture Capital Support.” conducted a survey of 30 US VCFs to find out the entrepreneurial qualities that they (VCFs) consider necessary for accepting an investment request as well as the quality of management team. The authors’ investigation revealed that in the VCFs’ assessment of a venture investment, the quality of management was a critical factor. It is the entrepreneur who collects the management team. Since it is the entrepreneur who establishes the business contact with the Venture Capital firm, he has to have critical traits.

MacMillan and Subba Narashimha (1987)\textsuperscript{31} in their research article entitled “Criteria Distinguishing Successful Ventures in the Venture Screening Process,” followed up their research with Zemann in 1987. They attempted to disclose how the evaluation criteria in use predict the success of ventures after the investment (MacMillan et al, 1987). They asked 67 Venture Capitalist respondents to rate highly successful and highly unsuccessful ventures, 150 ventures in total, on 25 screening criteria and on several performance criteria. They found two categories of evaluation criteria that predict the success of an entrepreneur: (1) entrepreneurs who lack experience, staying power, a product prototype, and a clear market demand; (2) entrepreneurs who in spite of good credentials face early competition; and (3) entrepreneurs with exceptional staying power but who easily lose the market to competition because of lack of product protection.


Khan (1987) in his research paper entitled “Assessing Venture Capital Investments with Non compensatory Behavioral Decision Models,” mailed questionnaires to 36 Venture Capital companies to validate the investment decision model. Khan developed actuarial decision models – conjunctive (non compensatory) and disjunctive (compensatory) – to describe the assessment of potential investments by Venture Capitalists and their attempt to identify the most successful ones. In arriving at their judgment, VCs tend to put emphasis on the entrepreneur’s desire for success and the uniqueness of the product or service relative to competition. Additionally, the study also suggests that VCs’ judgment is poorly related to actual outcomes and thus is not a good predictor of venture success. The most important investment predictor is the creativity and ingenuity of the entrepreneur, Market and marketing skills.

Robinson, R.B. (1987) in his research article entitled “Emerging strategies in the Venture Capital industry” Mailled questionnaires to 53 VCs, by using Descriptive statistics and Factor analysis he identified that management skills, venture team, references/track record, personal motivation, market growth, competitive threat, cash-out potential/liquidity, substantiated growth objectives are most important criteria’s in venture success.

Timmons, J.A and others (1987) in their research entitled “Opportunity recognition: the core of entrepreneurship”, by conducting unstructured interview to 47 VCs, by using content analysis they find out that management skills, venture team, references, degree of product differentiation, market acceptance, product line, growth path, market size, market growth, barriers to entry, competitive threat, cash-out potential/liquidity, size of investment, value added stream are important criteria.

Clarke (1987) in his research article entitled “Venture Capital in Britain, America and Japan’ focused his work on a comparative study of the Venture Capital operations in the USA, the UK and Japan. He showed that the Venture Capital

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35 Clarke, Modney (1987), “Venture Capital in Britain, America and Japan”, Croommelm
development in the UK was on the USA pattern while it was different in Japan. They attributed the difference to cultural and attitudinal factors.

**Ruhnka and Young (1987)** in their research article entitled “A Venture Capital Model of the Development Process for New Ventures.” has ascertained that CEO characteristics serve as the main object of attention at the early stages of assessment, whereas, later VCs pay more attention to the quality of the top management team. Many studies have shown that VCs analyze the make-up of the management team as a whole rather than focus exclusively on the lead entrepreneur. In addition, VCs evaluate whether the management team is balanced, complete, and prone to intergroup conflicts.

**Sandberg, W.R. and others (1988)** in their research article entitled “The Use Of Verbal Protocols in Determining Venture Capitalist’ Decision Processes” by conducting interviews, simultaneous verbal protocols with sample size of one, through content analysis determined that management skills, product attributes, competitive threat, expected rate of return are important in Venture Capitalist decision processes.

**Keeley, R.H. and Roure, J.B. (1989)** in their research article entitled “Determinants of new venture success before 1982 and after a preliminary look at two eras”, found that determinants of new venture success by using archival date from business plans with a sample of four and using descriptive statistics, regression analysis, they identified that management skills/experience, venture team, management stake in the firm, degree of product differentiation, market structure, market growth, barriers to entry, competitive threat, venture dealing stage are determinates of new venture success.

**Hisrich and Jankowicz (1990)** in their research article entitled “Intuition in Venture Capital decisions: An Exploratory study using a new technique”, used in-depth interviews with five VCs and repertory grid methodology. Their results showed
that the issues of interest in the investment decision can be grouped in three areas: management, unique opportunity and appropriate return. According to their study, Venture Capitalists mostly attach importance to management consisting of different constructs: the general traits of the proposer, the experience of the principal, the characteristics of the management team, and continuity of the company/market. The unique opportunity was also found to be generally used in the evaluation of investment proposals and was primarily associated with finding a market niche and the uniqueness of the product.

Riquelme and Rickards (1992) in their research article entitled “Hybrid conjoint analysis: an estimation probe in new venture decisions”, a VC’s decision-making process can be modeled with hybrid conjoint models. The use of a real-time technique – conjoint analysis – allowed them to better capture the complexity of VCs’ priorities and trade-offs among criteria in their evaluation of new venture proposals. The research demonstrated that initially, VCs focus on a small subset of criteria. In a second phase, VCs end a detailed examination by choosing the most preferred ventures through the acceptance of a lower value on one criterion compensated by a high value on another. The models confirmed the emphasis that VCs put on the entrepreneur’s experience during the first stage of the evaluation of business proposals (the ‘screening step’ of Tyebjee and Bruno (1984)). In addition, unique features of the product and the presence of a functioning prototype proved to be important criteria as well. The main considerations identified in the second stage (the evaluation phase) are patent for product protection from competition and product gross profit margin.

Ray and Turpin (1993) in their research article entitled “Venture Capital in Japan” analyzed the investment activities of Venture Capital firms in Singapore and Japan, respectively. Both in Singapore and Japan, the entrepreneur’s personality and experience were found to be the most important aspects and financial considerations as the least important in the evaluation of the venture investment. Similarities among the top criteria used in the US, Singapore, and Japan were: entrepreneur’s sustained intensive efforts, his familiarity with the target market and his ability in evaluating

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and reacting well to risk. US and Singapore VCs also gave top consideration to demonstrated leadership and at least 10 times returns in five to 10 years while, for Japanese VCs, market growth rate, liquid investment and creating a new market were additional significant factors.

Hall and Hofer (1993)\(^{42}\) in their research article entitled “Venture Capitalists' decision criteria in new venture evaluation” study attempted to uncover the criteria used by Venture Capitalists through semi structured interviews and verbal protocol analysis of Venture Capitalists' evaluations of actual venture proposals. Sixteen verbal protocols - in which the participants “think aloud” as they review business proposals - were made of Venture Capitalists' venture evaluation decisions. The findings of this study suggest that Venture Capitalists screen and assess business proposals very rapidly: the subjects in this study reached a GO/NO-GO decision in an average of less than six minutes on initial screening and less than 21 minutes on proposal assessment. In Venture Capitalists' initial proposal screening, key criteria identified include fit with the venture firm's lending guidelines and the long-term growth and profitability of the industry in which the proposed business will operate. In the second stage of proposal assessment, the source of the business proposal also played a major role in the Venture Capitalists' interest in the plan, with proposals previously reviewed by persons known and trusted by the Venture Capitalist receiving a high level of interest.

Fried and Hisrich (1994)\(^{43}\) in their research article entitled “Toward a model of Venture Capital Investment Decision Making”, revisited the existing evaluation criteria without statistical manipulation by re-categorizing the criteria into three sets of generic criteria based on three basic constructs: concept, management, and returns. Four components of the concept include potential for earnings growth, viability and novelty of the project, competitive advantage, and reasonable overall capital requirements. Several attributes that Venture Capitalists want to see managers are personal integrity, track record, realistic risk identification and risk dealing, strong work ethic, flexibility, thorough understanding of the business, general management


experience, and leadership capabilities. Finally, the three components of returns that have been found include exit opportunity, potential for high rate of return, and potential for absolute returns.

Rah, Jung, and Lee (1994) in their research article entitled “Validation of the Venture Evaluation Model in Korea”, applied the 1984 work of Tyebjee and Bruno and the 1985 MacMillan list to tailor evaluation criteria for Korean Venture Capitalists. Their classification of criteria is somewhat different from those of the Americans. In order of average mean, the important investment criteria are divided into six clusters: (1) managerial capabilities: credibility, concentration and enthusiasm, organizational management ability, insight and forecasting ability, past experience in related business risk management ability, degree of technical knowledge, educational background and careers, past management record, and outsiders’ view of management ability; (2) market attractiveness: market growth potential, market size, market acceptance of product, degree of sales distribution channel, market development and sales strategy, and degree of client procurement; (3) superiority of product and technology: degree of technical manpower, degree of core technology, technology development capability, superiority of product performance, price competitiveness, degree of product margin and uniqueness of product; (4) Financing ability: financing ability, informal acquaintances, and collateral status; (5) availability of raw materials: stable supply of raw materials, and price stability of raw materials; and (6) production capability: degree of equipment facilities, ease of labor procurement, and properness of facility layout.

Pandey I M, Jyoti P Gupta and R M D Wickramatilake (1995) in their research article entitled “Venture Capital Investment Process and Evaluation in a Developing Asian Country; A study of Thailand”, the purpose of this paper is to provide empirical evidence of the Venture Capital activity in a developing Asian country, which is Thailand. This paper has two parts, first, they analyzes the Venture Capital investment process of the Venture Capitalists in Thailand. Second, they investigated into the criteria used by Thailand Venture Capitalists for evaluating Venture Capital investments. To analyze the Venture Capital investment activity of

the Thai Venture Capitalists, they followed the model suggested by Tyebjee and Bruno (1984) and to investigate the criteria they followed the methodology similar to the one used by MacMillan et.al. (1985) they found that there were fifteen VCFs in operation in Thailand at the beginning of 1995. Nine of them responded to their questionnaire; thus giving 56 percent response rate. The top ten criteria identified by their study are: well thought strategy to remain ahead of competition, integrity, familiar with target market, managerial skills, and balanced team. Long-term vision, demonstrated market acceptance of the product, urges to grow, high market growth, financial skills.

Pandey, I M (1996) in his research article entitled “Venture Capitalist’s Evaluation Criteria in a Developing Country: A Case of India”, in the study to evaluate criteria being used by the VCs in India, found that out of the top five criteria, most frequently rated as essential, four relate to the entrepreneur’s personality, viz., integrity, urge to grow, long-term vision and well-thought strategy to remain ahead of competition. The sample consisted of nine VCs. Pandey concluded that VCs in India consider the entrepreneur’s integrity and urge to grow as the most important critical aspects of venture evaluation, but a very low priority to the high-tech component of the product, untapped market, and venture returns. As noted above, these results are suspect since the data were gathered when the Indian Venture Capital industry was extremely immature.

Gupta, J P, Pandy, I M and Wickramatilke, R M D (1996) in their research article entitled “Venture Capital in a Developing Country: A Case study of Sri Lanka” they found that in Sri Lanka, the top criteria preferred by Venture Capitalists are; potentially high growth, return, liquidity and technologically skilled venture team. The entrepreneur’s integrity and sustained efforts are additional important evaluation criteria.

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Muzyka and others (1996)\textsuperscript{48} in their research article entitled “Trade-offs in the investment decisions of European Venture Capitalists”, used conjoint analysis as a valuable tool to examine trade-offs in 35 selection criteria made by European Venture Capitalists. In sum, this first cross-national comparison revealed that VCs evaluate potential investments in terms of a capable management team and acceptable financial and product-market criteria, while overall fund and deal characteristics seem to be second-order issues. Consistent with previous studies, the ‘human factor’ was judged to be the most important criterion in the VC investment decision, since all five management team criteria were at the top of the rankings. These criteria included the leadership potential and the track record of the lead entrepreneur and the management team as well as the presence of recognized industry expertise in the team. In addition, via cluster analysis three groups of VCs were identified: investors who prefer a national location, a second group that focuses predominantly on the characteristics of the deal and mainstream investors who consistently and instinctively rank the five management team criteria at the top of their list.

Pandey, I M and Jang, Angela, (1996)\textsuperscript{49} in their research article entitled “Venture Capital for Technology Financing in Taiwan”, they found that the five top most criteria considered by Venture Capitalist while financing in Taiwan are; return on investment, entrepreneurs’ technical skills, market need for product, growth potential for the market and liquidity of investment.

Lindle Hatton, Josef Moorehead (1996)\textsuperscript{50} in their research article entitled “Determining Venture Capitalist Criteria in Evaluating New Ventures”, a questionnaire was administered to 86 Venture Capitalists that were part of a venture forum sponsored in the northern California region. The findings report the criteria Venture Capitalists use to determine funding on new ventures. Most important finding is the confirmation that the quality of the entrepreneur ultimately determines the funding decision. However, the results indicate that market characteristics and financial considerations are more important in this study than they have been in previous research. Specifically, VCs expect the product to be capable of high profit

margins and provide exit strategies. It seems to indicate that VCs currently may be evaluating other criteria than just the entrepreneur. Nonetheless the entrepreneur’s characteristics are critical in successfully achieving funding for the venture

**Chotigeat, Pandey, and Kim (1997)**\(^{51}\) in their research article entitled “Venture Capital Investment Evaluation in Emerging Markets”, created a list of evaluation criteria and tested it within Taiwan, Thailand, and Sri Lanka contexts. Significance of criteria was ranked differently among the different countries. However, an entrepreneur’s characteristics are among the most important criteria in all three countries, confirming a similar finding in the U.S., Japan, Singapore, and India (Chotigeat et al 1997, Pandey 1995).

**Manigart and Wright (1997)**\(^{52}\) in their research article entitled “Venture Capitalist’s Appraisal of Investment Projects: An Empirical European Study”, investigated the investment appraisal and valuation process of Venture Capitalists, including information gathering, assessment of risk and required return, and the choice of valuation method. The study was conducted in the United Kingdom, the Netherlands, Belgium and France. Seven items were distinguished as possible indicators of the risk level of a project. The most important indicator of risk is the contribution by management in terms of their managerial skills, followed by the nature of the product market of the company, and the financial contribution by the management team. Much less important are the expected time horizon to the exit of the company, the expected time horizon to the redemption of preference shares, the expected participating dividend yield, and the nature of the capital market.

**Karsai and Wright (1998)**\(^{53}\) examined in their research article entitled “Screening and Valuing Venture Capital Investment: Evidence from Hungary, Poland and Slovakia”, the screening and valuation approaches used by Venture Capital firms in Hungary, Poland, and Slovakia and compared them to those of the United Kingdom. In screening issues, the most notable differences are the investee requirements for meeting financial ratio benchmarks. Market conditions have a

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greater influence in Hungary, Poland, and Slovakia than in the United Kingdom on the level of rate return sought from investment projects. In addition, product market factors are more important in the three countries in assessing projects’ risk level.

Zacharakis and Meyer (1998)\textsuperscript{54} in their research article entitled “A lack of insight: Do Venture Capitalists really understand their own decision process?” showed that Venture Capitalists are not good at introspection. Although they lack understanding of their own intuitive decision-making process, VCs are consistent in applying their decision procedures. The study draws on social judgment theory in order to provide a theoretical framework, which was lacking so far in studies on VC decision criteria. In contrast with the findings from prior studies using post-hoc methodology and consistent with the real-time study of Hall and Hofer (1993), entrepreneurial and team characteristics were found not to be the most important consideration in investment decisions when VCs have sufficient information about market characteristics. As indicated by Zacharakis and Meyer (1998), prior research needs to be reevaluated in terms of the importance attached to different criteria and the amount of information that VCs actually use in the evaluation process.

Golis, (1998)\textsuperscript{55} in his research article entitled “Enterprise and Venture Capital” The criteria used in the screening stage are: market size and potential growth; a significant competitive advantage; uniqueness of the product/service; management team; funding requirement; investment stage; the industry; profit potential; and economic return.

Shepherd (1999)\textsuperscript{56} in his research article entitled “Venture Capitalists' Introspection: A Comparison of "In Use “and "Espoused" Decision Policies”, carried out a survey on Australian VCs who ranked the following criteria more or less equally: Industry related competence, Competitive rivalry; Key Success Factor Stability; Lead Time; Timing of Entry; Scope; Mimicry of entry wedge etc. However, using the conjoint analysis method to show what VCs actually do (as opposed to what they say they do),Shepherd showed that the same VCs ranked industry-related competence (a Team characteristic) far higher than any of the other criteria.


Shepherd D.A (1999)\textsuperscript{57} in his one another research article entitled “Venture Capitalists’ assessment of new venture survival”, investigated criteria related to the school of strategy and identified the following considerations in the investment decisions: Market considerations, Competition considerations and Management capability. He found the identified “in use” criteria to be consistent with those proposed in the strategy literature.

Kaplan and Stromberg (2000)\textsuperscript{58} in their research working paper entitled “How do Venture Capitalists choose and manage their investments?” they tried to explain how Venture Capitalists screen potential portfolio companies. Consistent with prior research, the attractiveness of the opportunity – the market size, the business model, the technology, a high likelihood of customer adoption, and competition – the management team and the deal terms proved to be essential evaluation criteria for VCs. Additionally, this study highlighted the importance of the VCs’ initial assessment of the management quality for subsequent performance as the probability of an IPO (initial public offering) is higher for portfolio companies with strong management teams.

Zacharakis and Meyer (2000)\textsuperscript{59} in their research article entitled “The potential of actuarial decision models: Can they improve the Venture Capital investment decision?” they found, using conjoint analysis that the entrepreneur is not as important as shown in previous studies, and that Market and competition considerations were more important.

Vinay Kumar and Mohinder N Kaura (2003),\textsuperscript{60} the study attempted entitled “Venture Capitalists’ Screening Criteria”, to analyze the screening factors used by Venture Capitalists that help them in identifying successful venture teams and evaluating the attributes that distinguish the successful ventures from the unsuccessful ones. The Wilcoxon Signed Rank test confirms the findings by distinguishing the successful ventures from unsuccessful ones. The test brought out four important

variables which are highly unique to successful ventures in India which are: (a) ability to evaluate and react to risk, (b) attention to details, (c) market share, and (d) profits. The unsuccessful ventures, it seems, had problems in evaluating risk. Since successful teams focus on established markets and meticulously pursue these markets to gain market share, they achieve desired profits.

Kakati (2003)\(^6^1\) in his research article entitled “Success criteria in high-tech new ventures” investigated 38 criteria in six categories, that is, the four categories identified by MacMillan et al. (1987) and two additional categories, namely, Resource Based Capability and Competitive Strategy. It was found that a host of factors together influence the success or failure of new ventures. Thus using limited criteria may overlook important aspects of a venture. Kakati (2003:450) states that the “financial consideration itself is not an important determinant of a venture’s success but if the right entrepreneur, the right strategy and the right product are chosen, and the right capability is developed, returns will follow.” Kakati (2003) suggests a model that is extended to incorporate criteria related to entrepreneurs, resource-based capabilities, strategies, industry/market structure, fit between resource availability and strategies, fit between market structure and strategies, and an interaction of those factors.

Silva (2004)\(^6^2\) in his research article entitled “Venture Capitalists' decision-making in small equity markets: a case study using participant observation”, did not explicitly indicate the importance of the selection criteria, the case study agreed with prior literature that VCs heavily pay attention to information about the entrepreneurs, particularly their knowledge and contacts, their degree of commitment and their understanding of the business idea. The business idea itself was considered as an important criterion too, while financial projections do not seem to have a significant influence on the investment decision.

Mishra (2004)\(^6^3\) in his research article entitled “Indian Venture Capitalists (VCs) Investment Evaluation Criteria”, the study analyses the validity of venture evaluation model in India by directly comparing the relative importance of evaluation

criteria on the funding decision with the relative importance to factors influencing venture's empirical performance. In the light of the differences in investment opportunities around India, and the nature of industrial development in South East Asia in general, the author anticipated that the investment criteria employed by Venture Capital Firms (VCs) in India would differ. A questionnaire was administered to Venture Capitalists (regular members of Indian Venture Capital Association) to determine the criteria they use to decide on funding new ventures. The response rate was 100%. A list of forty two criteria was developed on previously developed lists. The criteria fell into six groups: the entrepreneur’s personality, the entrepreneur’s experience, characteristics of the product or service, characteristics of the market, financial consideration and characteristics of venture management team. Answers were given on a four point rating scale. The results reveal that criteria adopted by Indian VCs are different from those adopted by VCs in other countries including US. The results also confirm that the entrepreneur’s personality and experience are seen as being primary indicators of the venture’s potential.

Lerner (2004) in his research article entitled “When bureaucrats meet entrepreneurs: The design of effective “public Venture Capital” programs” enumerates criteria similar to those found by prior authors (promising technology, flexible and experienced management team, market size, fulfillment of market needs) and adds that, if available, the feedback from existing or potential customers is an important element to consider.

Florian Eisele, Christine Haecker and Ralf Oesterle (2004) in their research article entitled “German Venture Capitalists Investment Criteria over Financing Stages”; this study empirically explores the respective importance of a variety of criteria relevant for the investment decision of German Venture Capitalists. Based on the BVK (2000a) VC membership directory, 91 participants Venture Capital firm. Of these 91 VC firms, 61 firms were willing to participate, and 30 questionnaires were eventually returned in winter 2001. With a total of 91 suitable VC firms for their study, the 30 respondents imply a participation rate of 33%. They

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find that the relative importance of criteria varies with investment stages. In all stages, however, criteria in the personalities of management category as well as the appreciation potential of the acquired equity stake are considered crucial. Irrelevant are various market characteristics, dividend potential, as well as the desired independence level of management. Thus, this analysis provides all participants in the Venture Capital (VC) process with a comprehensive understanding of the parameters underlying the VC investment decision in Germany.

Abdul Rakhman (2005) in his research article entitled “Enhancing Venture Capital Investment Evaluation: A Survey of Venture Capitalists', Investees' and Entrepreneurs' Perspectives”, researcher investigates the use of investment criteria to evaluate potential partners who seek Venture Capital. The survey was undertaken in the South Sulawesi Province of Indonesia. There were 257 respondents who completed questionnaires. Three groups participated in this survey: Venture Capitalists (VCs), firms that provide Venture Capital funds to entrepreneurs to develop their businesses; entrepreneurs, who might seek Venture Capital in the future; and investees, businesses currently in receipt of Venture Capital. The three groups were asked to judge how important a range of investment criteria was, using a four-point scale. Each group used a different questionnaire and several variables were designed to cover investment criteria that were only relevant to VCs, entrepreneurs or investees. Data analysis indicated that, for several criteria, VCs shared interests with entrepreneurs and investees. However, the three groups did not always share investment preferences. VCs paid a lot of attention to the financial aspects and personality and experience of entrepreneurs in assessing the proposed businesses. They were concerned with the availability of raw material, marketing skills, fair trading and legal action. Entrepreneurs rated the ability to manage risks, product being well accepted and ability to attract customers as very important, and audited financial report and relationship with VCs as important. Investees emphasized honesty, openness and approachability, the product being well accepted, ability to attract customers and VCs actively developing trust and relationship with investees. They also believed IRR to be important.

Pintado and others (2007)\(^{67}\) in their research article entitled “Venture Capital in Spain by stage of development”, did research on the Spanish Venture Capital market and had the following findings. All characteristics about the owner were found to be of high importance and were rated in the following order. Honesty and Integrity were rated as the most important, followed by Knowledge of the sector, Work experience, Management team, Leadership skills, and finally, Understanding of company objectives. There was a small standard deviation in the respondents’ ratings giving an indication of high agreement between them. Three of the product characteristics, that is, proven product success, product stage of life cycle and marketing strategy were ranked as important. Similarly, they had a small standard deviation indicating agreement between respondents. Market related issues rated higher than the requirement that the product be high tech, indicating that market issues relating to the product are more important than whether the product is orientated toward high technology. However, market related issues are generally ranked as being less important than owner and product characteristics.

Franke and others (2007)\(^{68}\) in their research article entitled “Venture Capitalists’ Evaluations of Start-up Teams: A Discrete Choice Conjoint Analysis”, have argued that the quality of human capital in new ventures has the strongest impact on VCs’ funding decisions. It appears that VCs’ rationale for emphasizing the quality of the TMT (Top management team) on the whole rather than the CEO’s objective characteristics lies in that ventures rarely have enough resources for attracting the top talent. A balanced TMT sufficiently diversified in terms of members’ functional backgrounds and talents signals operational competence of a venture. In addition, an impressive TMT provides some evidence of the CEO’s leadership potential, and the CEO’s ability to pick the right people to make up for its own deficiencies.

Van Deventer and C. Mlambo (2008)\(^{69}\) in their research article entitled “Factors influencing Venture Capitalists project financing decisions in South Africa” this study explores and identifies the investment criteria used by South African


Venture Capitalists in their venture screening and evaluation processes. By using a Likert scale type of questionnaire, South African VCs were asked to rate the investments criteria identified in similar studies of abroad and to report any additional criteria of their own. By evaluating the mean rating, it was found that South Africa VCs consider the entrepreneur’s honesty and integrity; a good expected market acceptance; and a high internal rate of return to be the three most important criteria. The result of this study are deemed useful to both Venture Capitalists in their decision making process and to entrepreneurs in their Venture Capital applications to maximize their success rate.

Pankaj Patel, Rodney D’Souza (2008) in their research article entitled “Uncovering Knowledge Structures of Venture Capital Investment Decision Making” Studies on Venture Capital (VC) investment decision using espoused criteria and utility aggregation methods have shown mixed results. Using a latent decision structures approach from psychological scaling literature, they reduce random and systematic biases arising from VC decision environment. In addition, they further address such biases using a combination of parametric and nonparametric techniques and practitioner specified decision criteria on 143 funded and non funded business plans. Compared to previous studies that have emphasized the central role of the venture team in obtaining funding, they found that (a) a good venture team is critical for not rejecting a business plan but is less critical for funding a business plan (b) a good venture team has decreasing returns even for funded ventures, but favorable competitive conditions and market potential have increasing returns.

Wong (2009) in his research article entitled “Effective Evaluation Criteria for Successful Ventures: A Study of Venture Capital in Hong Kong”, surveyed 100 Hong Kong Venture Capitalists to find out which investment criteria identified in previous studies were useful predictors of venture performance. The study ranked characteristics of the venture team as the top criterion.


Khoso Imamuddin (2009) This paper entitled “Pakistani Venture Capitalists Investment Criteria: A Comparative Look”, has two objectives. First, it identifies investment criteria used by Pakistani Venture Capitalists (VCs) in the investment evaluation process. Second, it analyses how Pakistan VCs decision policies differ from their US and Indian counterparts. It is found that among Pakistani VCs, the factors related to the entrepreneur and management team are considered predominant and decisive in making investment decisions. Pakistani VCs rely heavily on a relationship-based approach in decision policies and may gradually move to a market-based approach once the economy's formal institutions attain stability. A relationship-based approach focusing on social networks can help substitute for formal institutions such as law, regulation and enforcement, which would facilitate the process of financial and non-financial transactions in the operation of Venture Capital markets in emerging economies. The differences he observed among US, Indian and Pakistani VCs decision policies regarding the use of investment evaluation criteria reflect the differences in institutional contexts. The results are in line with agency theory prescriptions that a relationship-based approach may be better suited to mitigate the agency problem, particularly adverse selection and moral hazard problems, by implementing the four prescriptions proposed by Ian and Peter (1994).

Jose Carlos and others (2010) in their research article entitled “Which Criteria Matter Most in the Evaluation of Venture Capital Investments?” this study identifies the importance assigned to the various criteria used by the Portuguese Venture Capitalists (VCs) to evaluate and select early stage Venture Capital projects. The data was collected through a questionnaire answered by 20 Portuguese VCs. they use descriptive statistics techniques and non-parametric tests to identify the most valued criteria and test differences in the importance assigned to the criteria of several types of VCs and investments. The study reveals that the personality and experience of the entrepreneur and of the management team are the most valued groups of criteria. VCs with a majority of private share capital value more the personality of the entrepreneur and management team than the companies with a majority of public share capital. Additionally, the VCs that did not yet internationalize consider the


personality of the entrepreneur and management team and the financial aspects, to be more important than the VCs that have already expanded abroad.

**Cheedradevi Narayanasamy (2011)** in his research paper entitled “Venture Capital Pre-Investment Decision Making Process: An Exploratory Study in Malaysia”, he stated that Venture Capital is an alternative source of funding for SMEs in this country. Recognizing the importance of this industry toward economic growth, Malaysian government has initiated various strategic plans. Despite the promising growth of Venture Capital market here, past empirical findings reveal that the performance of Venture Capital backed companies (investee companies) over long run has been relatively poor, especially after Venture Capitalist exit. Thus, there is a need to understand the decision-making process practiced by Malaysian Venture Capitalists. Most decision making process evolve from classical decision-making model, hence current study purports to find the disparity between the current practice and classical Venture Capital decision-making model. The current study incorporates an exploratory research through survey of 16 Venture Capitalists. Findings reveal there are significant similarities in the decision making procedure and investment criteria used to select investment deal with the classical model. Similarities noted in the last two stages of decision-making. As for investment criteria, greater importance is given to management integrity and exit opportunity rather than to the business idea. Findings also reveal that VCs experience does not correspond to expertise in decision-making.

**Srinivas and N Nagaraja (2013)** in their research study entitled “Venture Capital Firms Assessment Criteria while financing for New Enterprises in Karnataka”. Study addresses the investment criteria used by Venture Capital Firms of Karnataka in their financing decisions to new enterprises. Using four point Likert scale type of questionnaire, Venture Capital firms of Karnataka were asked to rate the investment criteria. By evaluating the mean ratings, it was found that Venture Capital firms of Karnataka consider the Entrepreneur’s honesty and integrity, Long term vision, Urge to grow, High-tech product, Uniqueness of the product, High market

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growth rate, Balanced team, Capable of sustained intense efforts, high internal rate of return, Easy market acceptability are the top ten most important criteria’s considered by Venture Capital firms before financing the new enterprises

3.4 Literature on Venture Capitalists Involvement and Return

Blaine Huntsman and James P. Hoban (1980) in their research article entitled “Investments in new enterprise: Some empirical observations on risk, return and market structure”, have constructed a portfolio composed of 110 venture investments in 50 different companies made by four different Venture Capital firms during the period 1960-1968 in United States. The annualized rate of return generated by the composite portfolios of the entire 110 venture investment sample (after search and investment management costs) was 18.9% over the fifteen year period 1960-1975. To test the dependence of venture portfolio performance upon a relatively few highly successful individual investments, they conducted simulation and found that venture portfolio performance has shown high degree of sensitivity to few individual investments with high rates of return. Finally they have concluded that 1) an attractive rate of return can be generated over time by well-diversified venture portfolios, but 2) adequate diversification requires greater minimal capital levels than may be the case for portfolios containing securities of more mature enterprises with readily marketable securities.

Martin and Petty (1983) in their research article entitled “Analysis of the performance of Publicly Traded Venture Capital Companies” analyzed the performance of eleven publicly traded Venture Capital firms. They computed the rate of return on the publicly traded stock for each of the 6 years in the period 1974-79, and they found the average rate of return over this period to be 27%.

Stevenson, Muzyka and Timmons (1987) in their research article entitled “Opportunity recognition: The core of entrepreneurship”, applied a Monte-Carlo simulation to create a realistic model that explains investment patterns of Venture

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Capital companies. In general, a Monte-Carlo model is a computer simulation with a built-in random investment strategy (Wright 2002). It accommodates variables with both dynamic and continuously changing characteristics, fundamentally meeting the nature of Venture Capital investment contingencies. The outcome from the simulation sheds light on conditions leading to higher rate of return on investment. The conditions include multi-staged investment objective evaluation, parlaying funds, persistence of returns form one round of investment to the next and long-term holding of investment.

**Warne (1988)** in his research entitled “Essays on the Venture Capital Market” explores why Venture Capital provides capital and assistance jointly, when they are available separately in competitive markets. According to the author, if there are joint economies in the provision of capital and assistance, then there is a clear advantage to Venture Capital. Such economies of scope may be justified by elimination of duplicate monitoring by the entrepreneur if capital and assistance are provided separately. Another reason is the fixed costs of investigating the project and the entrepreneur. One might add the possible moral hazard problems that may arise between the financier as principal and the consultant as an agent.

**Gorman and Sahlman (1989)** in their research article entitled “What do Venture Capitalists do?” in this study confirm that Venture Capitalists devote considerable time to oversee their portfolio companies, e.g. visiting them and reviewing their financial performance.

**Sophie Manigart and others (1990)** in their research article entitled “Determinants of required return in Venture Capital investments: a five-country study” Using two complementary theoretical perspectives, they develop hypotheses regarding the determinants of the return required by Venture Capitalists and test them on a sample of over 200 Venture Capital companies (VCCs) located in five countries. Consistent with resource-based theory, they find that early-stage specialists require a significantly higher return than other VCCs when investing in later-stage ventures. Consistent with financial theory, they found that acquisition/buyout specialists require

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a significantly lower return than other VCCs when investing in expansion companies. Furthermore, in comparison to specialists, highly stage-diversified VCCs require a significantly higher return for early-stage investments. Independent VCCs require a higher rate of return than captive or public VCCs. In general, higher required returns are associated with VCCs who provide more intensity of involvement, have shorter expected holding period of the investment, and being located in the US or UK (in comparison to those in France, Belgium, and The Netherlands).

**Chan and others (1990)** 82 in their research article entitled “Learning, corporate control and performance requirements in Venture Capital contracts”, develop an agency model in order to explain why Venture Capital contracts combine a risky claim for the Venture Capitalists with disproportionate control and contain explicit covenants permitting passage of control to the Venture Capitalist following a poor performance by the entrepreneur. The authors therefore develop a two-period agency model, in which both the Venture Capital and the entrepreneur have the skill to control production, but the latter’s skill is unknown to both at the time of contract signing. Interim information arrival reveals this skill to both parties and is used to determine who controls second period production.

**Ray (1991)** 83 in his research paper entitled “Venture Capital and Entrepreneurial Development in Singapore”, revealed some significant differences between the US and Singapore. Singapore’s VCs gave more importance to the creation of a new market and having acceptance in the established market. Ray argued that, given its small domestic exports, it is probably easy for entrepreneurs in Singapore to create new export markets. The US has the largest domestic markets in the world, therefore, creation of a new market and the acceptance of the venture in existing markets were not important considerations for US VCs. As in Singapore, VCs in Japan are significantly concerned about the creation of new markets. Also, Japanese VCs contrasted with their US counterparts, have a narrow range of criteria for rejecting a proposed venture investment. Most VCs in Japan relied heavily on outside specialists in evaluating products, technology and markets. The VCs relied

heavily on their own intuition, however, in appraising all aspects of proposal including finance and production. Ray (1991) found a similar pattern for Singapore.

**Sapienza (1992)**\(^8^4\) in his research article paper entitled *“When Do Venture Capitalists Add Value?”*, found that the average value-added by Venture Capitalist, as perceived by both Venture Capitalists and entrepreneurs, is significantly positively related to the level of innovation and performance of these companies. The frequency of contact between the two, as well as value-added, is significantly negatively correlated with the stage of the venture. The assistance provided by Venture Capitalist is particularly useful for small, highly innovative ventures. Venture Capitalists that focus on early-stage investments are more willing to exercise control and spend more time over the project than other Venture Capitalists. Provision of money alone appears to play a necessary but far-from sufficient condition to promote economic growth and resilience; evidence is mounting that Venture Capitalists do add value.

**Gupta and Sapienza (1992)**\(^8^5\) in their research paper entitled *“Determinants of Venture Capital Firms Preferences Regarding the Industry Diversity and Geographic Scope of Their Investments”* try to identify some factors affecting VCs’ preferences regarding industry and geographic scope of their investments. They argue that VC funds investing only in early-stage firms would prefer more industry and geographic diversity because of the high risk involved in early-stage financing. They also suggest that larger VC funds tend to be more diversified because larger funds need more projects to invest in and their managers may possess Superior capabilities relevant to a wider set of investment opportunities. Using a sample of 169 Venture Capital funds, they find some support for their hypotheses. However, the data for this study was obtained through questionnaire surveys completed by sampled venture firms. Those firms were asked about their willingness to invest in multiple industries and geographic areas. So the proxy for fund specialization used by Gupta and Sapienza is a measure of VCs’ personal preferences rather than the actual investment patterns. Furthermore, Gupta and Sapienza do not consider another important aspect of VC investment, specialization choices regarding stage of development. In sum, both of the above papers use questionnaires and small samples of VC funds. Their

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specialization measures reflect the subjective intentions of VCs, but not the true investment patterns of the funds.

**Norton and Tenenbaum (1993)** in their research article entitled “Venture Capital portfolio” they ask the simple question of whether the VC firms tend to be diversified or specialized in their portfolio construction. They collect survey data from 98 Venture Capitalists. Their specialization measures denote the number of industries or the number of companies in a venture portfolio. They first look at the correlation coefficients between the specialization measures and the percentage of funds invested in early stages. But the results are mixed. They further propose that if VCs specialize by stage, the percentage of financing in a given stage may be positively related to those of nearby stages as a result of follow-on investments. By examining the correlation coefficients between the percentages of funds in each financing stage, they claim that VC firms appear to specialize by stage.

**Bowden (1994)** in his research article entitled “Bargaining, size and return in Venture Capital funds”, follows a co-operative-game approach to examine conditions for existence of a Pareto-optimal contract between the Venture Capitalist and the entrepreneur. These include that the entrepreneur is (a) more risk-averse, or (b) more optimistic (has different expectations) than the Venture Capitalist.

**Gompers and Lerner (1994)** in their research article entitled “An analysis of compensation in the US Venture Capital partnership”, examine the mature of Venture Capitalists incentive compensation in 419 venture partnership agreements and “offering memoranda” for funds formed between 1978 and 1992. They find that compensation for older and larger Venture Capital organizations is more sensitive to performance than the compensation of other venture groups. The profit participation and other aspects of the contract encourage the Venture Capitalist to allocate the management fee to activities that will increase the total value of the portfolio. The general partners cannot choose to invest in securities that serve their own private interests at the expense of the limited partners. Finally, the contract addresses obvious areas of conflict between the Venture Capitalist and the limited partner. Thus, the
Venture Capitalist is often explicitly prohibited from self-dealing. Also, the Venture Capitalists are contractually required to commit a certain percentage of their effort to the activities of the fund

Zider (1998)\(^{99}\), in his research paper entitled “How Venture Capital works” there are four major participants in the Venture Capital industry, namely, the entrepreneur who needs the funding, the investor who wants the high return, the investment bankers who need companies to sell and the Venture Capitalists who want to make money. This is made possible by the creation of a market for the players mentioned.

Pandey (1998)\(^{90}\) in his research article entitled “The Process of Developing Venture Capital in India” investigates the process of developing Venture Capital in India through TDICI. In the initial years they face a lot of problems, like in raising funds and evaluating prospective business. Initially they focused on high-tech industry but later on they shifted to profitable industry. Later on the firms get flourished and took initiatives to develop VC industry in India

Chen and others (2002)\(^{91}\) in their research paper entitled "Venture Capital and its role in strategic asset allocation." examined 148 Venture Capital funds which had been liquidated before 2000 in US. They found an average annual return of 9.99\%, with the highest annual IRR of 74\% and the lowest of -72\%.

Jones and Rhodes-Kropf (2003)\(^{92}\) in their research working paper entitled “The price of diversifiable risk in Venture Capital and private equity”, with 1245 PE funds they focused on portfolio company level and found in their analysis that the US VC funds have a value-weighted IRR of 19.3\%.

Kaplan and Per Stromberg (2003)\(^{93}\) in their research working paper entitled “How Do Legal Differences and Learning Affect Financial Contracts?” finds that the Venture Capitalist plays a primary role in shaping the top management team of the

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companies in which they invest. The authors also report that the monitoring activities of Venture Capitalists are closely related to their pre-investment appraisal and the structure of the financial contracts.

Mayer, Schoors and Yafeh (2005)\textsuperscript{94} in their research paper entitled “Sources of Funds and Investment Activities of Venture Capital Funds: Evidence from Germany, Israel, Japan and the United Kingdom” compare VC fund investment focus and sources of finance across Germany, Israel, Japan, and the United Kingdom. Using a dataset of 508 venture funds, the empirically explore whether the sources of funds are related to the stage, industry, and geographic focus of those funds. Their empirical results show some relationship between fund specialization and VC financing. However, much of the within and cross-country variation is not mainly due to sources of funds. Mayer, Schoors and Yafeh finally conclude that the pronounced differences of VC investment focus in these four countries are not primarily related to either financial systems or sources of funds.

Gompers, Kovner, Lerner and Scharfstein (2006)\textsuperscript{95} in their research working paper entitled “specialization and success; Evidence from Venture Company”, examines how organizational structure of VC firms, particularly the degree of specialization, affects the performance of Venture Capital firms. They measure specialization at the VC firm level and also at the individual Venture Capitalist level. Using a dataset containing 2690 Venture Capitalists from 768VC firms, Gompers, Kovner, Lerner and Scharfstein find a strong positive relationship between the degree of specialization by individual VCs at a firm and its success. The effect of firm-level specialization on fund performance is much weaker when the individual VCs are highly specialized. However, Gompers, Kovner, Lerner and Scharfstein only study the effect of industry specialization on VC firm success. How specialization by stage and geography affects fund performance is still unclear. Furthermore, they take the specialization choices of VC firms as given. How VCs choose different degree of specialization in the first place is not addressed.


Rajan (2009) in his research paper entitled “India Venture Capital and Private Equity 2009” introduced a VC/PE data sample in India for the period 2004-2008. The results indicate large proportions are round 1 investment with a dramatic decrease in subsequent rounds. Most of the investment are late stage and characterized by short duration. These factors don’t favor long-term growth of VC industry in India.

Dheeraj Pandey and Thillai Rajan (2011) in their research paper entitled “Empirical Study on Venture Capital and Private Equity Investments: US and India” the study investigates dotcom influence on US VC industry, investment patterns comparisons across industries & exit strategies. The sample period considered is US data for a period of 1990-2009 from Venture Economics and Indian data for a period of 2004-2008 from Venture Intelligence. The dot-com effect is still persisting. The factors determining the investment patterns are mostly associated with monitoring and agency cost associated with firm. Firm’s exiting via an M&A is frequently monitored for a long time and hence risky, responsible for lower fund raising. The data analyzed also shows the attractiveness as well as immaturity of Indian VC industry.

Reddy A.P and Venkata Subbaiah (2011) in their research article entitled “A study with reference to APIDC VCL” they evaluate the performance of APIDC VCL in Venture Capital financing. Source of fund mobilization of APIDC VCL indicates that between 1994 -2002 there was an additional fund mobilization of Rs. 1773 lakhs to an initial fund amount of Rs.314 lakhs. The major source of additional fund was WB, SIDBI, IDBI, during period 1996-97 and 2005-06 fair value of investment of APIDC VCL was 27 percent during the study period.

Literature review of above pages clearly emphasis a need for the study of performance of Venture Capital and its funding in Karnataka. Above studies were categorized and analyzed from the point of view of Stages of Venture Capital Investment Process, Venture Capital Investment Criteria and Venture Capitalists.

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involvement and return for their investment. Though there is a galore of literature related to Venture Capital, none of the above studies have pioneered on the Venture Capital Performance in relation to promotion of Knowledge based industries for the economic development and their investment or funding. From these things it is proved that definitely there is need to carry out a study on performance of Venture Capital in Karnataka. The researcher found an extensive and exhaustive gap in the aforesaid pages and cases. Hence the present study is carried out to achieve the identified gap.