2.0 Introduction

World is passing through a phase of knowledge economy, where technology and knowledge based ideas are set to drive the global economy (Taneja, 2002). In this phase, knowledge-intensive, high-technology industries are expected to be the most critical and strategic industries for the survival and the growth of companies, regions, and nations (Sung, Gibson, and Kang, 2003). Given the inherent strength by way of its human capital, technical skills, cost-competitive workforce, research and entrepreneurship, India can unleash a revolution of wealth creation and rapid economic growth in a sustainable manner. For this to happen, there is a need for risk finance and venture capital environment which can leverage innovation, promote technology and harness knowledge based ideas (Selvakumar and Ketharaj, 2009). Thus, venture capital plays a key role in the entrepreneurial process by providing equity capital and managerial support for young, rapidly-growing, high risk and high tech private companies with the potential to develop into significant global businesses (Mason and Harrison; 1999, Mishra et al.; 2005). Reflecting the overall importance of venture capital to entrepreneurship, it has received considerable academic attention. In this chapter, an attempt has been made to trace the development of venture capital literature, from the detailed descriptive studies that dominate early work to the theory driven analysis.

The institutional venture capital market was established by the end of 1940s in US; however, scholarly interest in the venture capital began only in 1970s but expanded substantially thereafter. This growth in venture capital research has been particularly strong since the late 1980s. The empirical research on venture capital was virtually non-existent before the decade of the 1990s (Mason and Harrison, 1999). A number of researchers from different disciplines such as management and entrepreneurship, finance and economics provided different concepts and methodological approaches in order to understand venture capital finance. Considerable interest was developed by the researchers mainly from the US, being a home for the most vibrant and dynamic venture capital market for the world, after 1980 (Landstorm, 2007).
One of the earliest interests in the venture capital in 1960s came from researchers in the field of general management and in the field of finance in 1970s. A considerable amount of work was produced on the role of finance in the development of entrepreneurially driven emerging growth company, particularly technology based spin-off firms. Throughout the 1970s attention was devoted to examining the investment and screening process from venture capitalist’s point of view i.e. a supply side perspective (Brophy, 1986). This interest on studying venture capital process is continued even today by many researchers (Sweeting, 1991; Bygrave and Timmons, 1992; Tyebjee and Bruno, 1984; Fried and Hisrich, 1994; Pandey and Jang, 1996; Isakkson, 2006; Klonowski, 2007). Most of the studies confirmed the general belief that quality of the entrepreneur/founding team and the marketability of the idea are central for success (Macmillan et al., 1985; Rah et al., 1994; Hall and Hofer, 1993; Tyebjee and Bruno, 1984; MacMillan et al., 1987; Hall and Hofer, 1993; Sandberg and Hofer, 1987; Zacharakis and Meyer, 1988). Yet another area of interest was the performance of the venture capital investments, and in several studies the annual rate of return on these investments was calculated.

Sapienza and Villanueva (2007) have identified certain dimensions that have been studied extensively and the ones that have been relatively neglected. The dimensions basically include the stages in the venture capital cycle, the perspective of the entrepreneur/venture capitalist and the type of the venture capital. These dimensions have been represented in the following diagram.
The figure indicates that the available literature on venture capital focuses upon institutional venture capital, from the investor's perspective and in the selection as well as monitoring stage in venture capital cycle. (These areas are marked in Bold). Studies by Tyebjee and Bruno, 1984; MacMillan et al., 1985; MacMillan et al., 1987; Sandberg and Hofer, 1987; Timmons and Bygrave, 1986; Gorman and Sahlman 1989; MacMillan et al., 1989; Maula et al., 2005; Dolvin 2005; Ehrlich et al., 1994; Busenitz 2004; Gabrielsson and Huse 2002; Sweeting and Wong 1997; Gomez-Mejia 1990; focused on these areas.

Sapienza and Villanueva (2007) have also identified the supporting reasons for special focus on these areas/dimensions. There are compelling reasons for such extensive studies on institutional venture capital as against the business angels and the corporate venture capital. As compared to angels, institutional venture capitalists are more visible, easier to locate and have more resources to devote to helping in research. And institutional venture capital industry has been more stable in terms of number of firms existing at one
time and in terms of prolonged existence of the firms as compared to corporate venture capital. While the value-added of independent venture capitalists has been studied extensively, there is significantly less research carried out on the value-added provided by corporate venture capitalists. This may be due to the highly cyclical nature of the corporate venture capital community (Maula, 2001). Further, in contrast to the transient nature of corporate venture capital specialist teams in large corporations, the average managing partnership of a VC firm is considerably more stable.

Besides, most of the extant research on venture capital is concentrated on supply side of the market i.e. from the investor perspective in comparison to demand side i.e. entrepreneurs’ perspective seeking venture capital. The reasons could be venture capitalists are the immediate stakeholders comprising the venture capital industry itself. As mentioned before, venture capitalists are more visible than entrepreneurs and are able to provide the researchers with access to large number of ventures.

With respect to focus on selection and monitoring stages, it is said that study of the under-researched stages like fund raising and exit involve individuals outside the venture capitalists-entrepreneur relationship i.e. fund raising involves limited partners and exit involves other organisations. And therefore, collection of information and the research designs would be more complicated. While with respect to selection criteria, information can be easily collected through questionnaire and interview methods, preferred by early researchers. Further, researchers became aware of dominance of post-investment activities in time spent by the venture capitalists, the force to understand this stage of venture capital cycle gained momentum. Researchers attempted to understand how venture capitalists added value beyond just providing financial support to entrepreneurs. And study of other stages of venture capital cycle is neglected so far.

Like Sapienza and Villanueva (2007), Mason and Harrison (1999) have also compiled the trends in the venture capital research. They observed that there has been a considerable expansion in the geographical focus of research from the US to the UK, Western Europe and Asia as well as an increasing volume of literature on cross-country comparisons. As mentioned before, various disciplines and interest groups have contributed to this expanding literature on venture capital including researchers from many other disciplines, including finance, accountancy, economics, sociology,
psychology and geography in addition to the dominant discipline management for the subject. These researchers with their different backgrounds added a variety of theoretical perspectives and methodological approaches. And finally as a consequence of the interests by the researchers from different disciplines, there has been an enormous expansion in the range of topics examined by them. Initial studies were mainly based on macro perspective i.e. investment trends in the venture capital market. Since then venture capital decision making has expanded to include a variety of subjects like, the relationships between investors and their investee companies, whether venture capitalists add value to their investee companies, the role of venture capital in management buyouts, the financing of technology-based businesses, exit routes of investors, the returns from venture capital investments and the geographical distribution of venture capital investments.

In this chapter, the literature on work done by various researchers across different stages of venture capital investing has been reviewed in detail. Studies in relation to generating deal, initial screening, evaluation, deal structuring, post-investment and exit stages have been referred at different points in the chapter. These studies have been bifurcated between international and Indian context. Since the thesis has main focus on Gujarat, studies on venture capital at the state level have also been reviewed. The present study is a comprehensive and covers many other aspects related to venture capital other than the decision making process. Hence, studies in relation to geography of venture capital investing, syndication of venture capital investment, use of bootstrapping techniques, incubation and angel capital have also been examined. The map of literature review followed in the present study has been described below.
2.1 Venture Capital Investing and Decision Making Process

As highlighted above, since 1970s most of the academic researchers tried to describe and understand venture capitalists’ decision making process (Silva, 2004). In western countries, the venture capital process has been described in numerous academic studies (Sweeting, 1991; Bygrave and Timmons, 1992; Tyebjee and Bruno, 1984; Fried and Hisrich, 1994). However venture capital investment process is a complex and unclear. It is still not obvious that how and on what basic factors the venture capitalists make their investment decisions. Each venture capital firm follows its own guidelines and rules and this create uncertainty (Ulu, 2008). Gorman and Sahlman (1989) phrased the questions *What do venture capitalists do?*, in trying to capture the main research question in this area. However, knowledge about the venture capital process has developed since then and shifted away from pure descriptive studies of venture capitalists to focusing more on the relational aspects of the venture capital process (Isaksson, 2006).
Tyebjee and Bruno (1984) proposed simplistic and descriptive five-stage model of venture capital investing (i.e. deal origination, screening, evaluation, deal structuring, post-investment activities). The model broadly highlights key venture capital activities at each stage and at the same time, the model also consolidates the heterogeneity of the investment process across different venture capital firms. Fried and Hisrich (1994) extended the previous research by Tyebjee and Bruno by investigating venture capitalists’ decision making in more detail.

However, there are very few studies in the context of Asian countries. Notable among them, are by researchers like, Rah et al., (1994), Pandey (1996), Pandey and Jang (1996), Mishra (2005), in the context of countries like Korea, India and Taiwan. Bygrave and Timmons (1992) argued that the venture capital industry was not the same everywhere; its nature differed from country to country. As reported by Pandey and Jang (1996), Clarke (1987) provided a comparative documentation of the venture capital operations in US, UK and Japan. He showed that venture capital development in the UK was similar to the US pattern, while it was different in Japan. He attributed the difference to cultural and attitudinal factors. The stages of venture capital investing process by various studies have been summarized in the table 2.0.

<table>
<thead>
<tr>
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<tbody>
<tr>
<td>Search</td>
<td>Deal Origination</td>
<td>Search</td>
<td>Generating deal flow</td>
</tr>
<tr>
<td>Screening</td>
<td>Screening</td>
<td>Initial Screening</td>
<td>Proposal Screening</td>
</tr>
<tr>
<td>Evaluation</td>
<td>Evaluation</td>
<td>-----</td>
<td>Proposal Assessment</td>
</tr>
<tr>
<td>-----</td>
<td>Deal Structuring</td>
<td>Due Diligence</td>
<td>Due Diligence</td>
</tr>
<tr>
<td>(a) Venture Board Meetings, (b) Venture Operations</td>
<td>Post-Investment Activities</td>
<td>Monitor Progress</td>
<td>Venture Operations</td>
</tr>
<tr>
<td>Cashing Out</td>
<td>-----</td>
<td>Cashing Out</td>
<td>Cashing Out</td>
</tr>
</tbody>
</table>


In the Indian context particularly, there are very few studies brought to the notice while reviewing the literature on venture capital investing process. These mainly include studies by researchers; Pandey (1996), Mishra (2005), Kumar and Kaura (2003) and Kumar and Vinay (2002) and Sharma (2002). By and large these studies mainly focus
upon the decision criteria used by the Indian venture capitalists for evaluation of the entrepreneurial firms. (These studies have been reviewed later in the following section). However, these are not comprehensive studies compiling all the stages of venture capital investment process starting from deal origination, screening, due diligence or evaluation, deal structuring, post-investment activities and exit as proposed by Tyebjee and Bruno (1984). Only one study by Sharma (2002) highlights the pre and post-investment behaviour of the venture capitalists across India conducted seven years before. The present study adds on many perspectives to this study by Sharma (2002).

Nature of the venture capital process involves transactions between investors (limited partners), venture capital firms (general partners) and the portfolio companies/entrepreneurs (Bygrave and Timmons, 1992). As such “agency theory” is a commonly used perspective to examine this process. Besides this theory, there have been some dominating approaches applied in examining the venture capital process such as resource dependency theory, stewardship theory, and stakeholder theory (Zacharakis and Eckermann, 2007). Various mechanisms such as VC-CEO interaction, establishment of control rights, staging of venture capital in investment rounds etc., developed as a result of potential agency problems. The problems like moral hazard and adverse selection arise due to asymmetric information in the marketplace surrounding firms seeking venture capital as these firms are often early stage, innovation-based or technology-driven companies (Makri et al., 2007). Thus, the logic of Agency theory and the Resource dependence theory would be more logical for discussion on the venture capital investing.

Agency theory is concerned with the risk of asymmetric information between outside investors and firm managers. Asymmetric information refers to a situation in which one party of a contract has access to relevant information not available to other party of the contact (Panwar, 2005). Amit et al. (1998) refers it as “hidden information”. The agency problem occurs when the goals of the principal and agent are different, and when it is difficult for the principal to know what the agent is actually doing. In the venture capital context it has been assumed that the venture capitalist is principal and the founder/manager is the agent, although there have been arguments of agency relationships both ways (Gabrielsson and Huse, 2002). As per the theory, contracting and
monitoring efforts can improve the portfolio performance by reducing possible losses caused by moral hazard and adverse selection (Berg-Utby et al., 2007).

Resource based arguments are concerned with ways of attracting and managing resources needed for firm success (Gabrielsson and Huse, 2002). This perspective views venture capitalists as providers of the resources beyond capital and scholars following this perspective focus on both human capital (VC’s expertise and experience) and social capital (VC’s access to the resources from other firms through their network) (Berg-Utby et al., 2007). Past research on the venture capitalist’s role as a resource provider has identified some most common forms of support like serving as a sounding board, strategic advice, general business knowledge, networks etc (Timmons and Bygrave, 1986; Gorman and Sahlman, 1989; MacMillan et al., 1988; Maula et al., 2005; Dolvin, 2005; Ehrlich et al., 1994; Busenitz, 2004; Sweeting and Wong, 1997; Gomez-Mejia, 1990). Reference to both these theories would be made at the relevant stages in reviewing the literature on venture capital investing in the following section.

Figure 2.2 Chart Describing Research Gap

<table>
<thead>
<tr>
<th>Review of International Studies on VC Investment Process</th>
<th>Research Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Review of Indian Studies on VC Investment Process</td>
<td>The extant research has focused on venture capitalists’ perspective. Entrepreneurs’ perspective is ignored</td>
</tr>
<tr>
<td>Review of Available Literature on VC for Gujarat</td>
<td>Studies on VC investment process focus upon evaluation criteria and value addition</td>
</tr>
<tr>
<td>Review of Studies on Geography of VC Investment, VC Syndication, Bootstrapping, Incubation and Angel Capital</td>
<td>Absence of prominent research on VC at Gujarat level</td>
</tr>
<tr>
<td>Most of the studies mainly carried out in US context.</td>
<td></td>
</tr>
</tbody>
</table>

Figure 2.2 Chart Describing Research Gap
2.1.1 Deal Origination and Screening Potential Investments

(a) Deal Origination

Deal origination describes sources of potential deal and how venture capitalists become aware of potential investment activities. Due to prevailing stiff competition among venture funds for good investments, sources of potential deals are a matter of concern for venture capital search. However, as per Zacharakis and Shepherd (2007), deal flow and due diligence are quite under researched. Deal flow and screening research draws heavily on agency theory. Amit, Glosten and Muller (1990) asserted that venture capitalists face a lemon problem in that only those entrepreneurs who can not raise cheaper capital from other sources will seek funding from venture capitalists. Given that traditional financiers insist on the availability of sufficient information to judge quality, lower-quality entrepreneurs will have no other financing option but private equity. These entrepreneurs withhold negative information or overstate the venture’s potential in order to attract investors and secure the cheapest financing available resulting into adverse selection problems (Zacharakis and Eckermann, 2007). Besides, venture capitalist faces a very poorly defined environment within which he has to find prospective deals. The typical investment prospect is too small a company to be readily identifiable as a potential candidate (Tybjee and Bruno, 1984). Therefore, venture capitalists need to find effective means to identify quality deal flow and screen out lower-quality entrepreneurs.

Studies conducted so far in this area highlight potential sources of deals (Tybejee and Burno, 1984; Fried and Hisrich, 1994; Pandey and Jang, 1996; Klonowski, 2007). As per these studies, deals can originate from various sources such as arising out of referral system, unsolicited calls by the entrepreneurs, active search by the venture capitalists themselves and deals within the venture capital communities. Deals may be referred to venture capitalist by their parent organisation, intermediaries, trade partners or friends. As per the findings of these studies, referral process is a primary source of deals for the developed countries, such as the US. Shane and Cable (2002) suggested that venture capital financing is a function of network ties and stronger the ties between entrepreneurs and investors, more likely the venture capitalists will fund entrepreneurs. Thus, as per the network theory venture capitalists generate deal flow by tapping their network. Better quality entrepreneurs will get warm referrals to venture capitalists by knowing someone
in the venture capital’s network that the venture capitalist respects and trusts (Tyebjee and Bruno, 1984 and Fried and Hisrich, 1994).

There are basically proactive and reactive approaches to discovering new venture opportunities for venture capital companies (Sweeting, 1991). As the name suggests, proactive venture capitalists are actively searching potential entrepreneurial firms through networks, tradeshows, seminars and conferences; to invest in while reactive venture capitalists wait for the business proposals to arrive. There are conflicting views about these methods. Fried and Hisrich (1994) observed that venture capitalists are considered to be rather passive at this stage, expecting the entrepreneurs to find them while Pandey and Jang (1996) has observed in their study that venture capital funds in Taiwan are rather active at this stage as they have accumulated a lot of money from the booming Taiwanese stock market which they would like to employ in profitable ventures.

As per the study of Klonowski (2007), initial deals in Central and Eastern Europe (CEE) during mid and late 1990s came mainly from privatization opportunities. He also stated the emergence of professional intermediaries in the venture capital industry.

Tyebjee and Bruno (1984) observed that potential deals are brought to the attention of venture capitalists from sources like unsolicited cold calls from entrepreneurs and referrals. Deals were referred to the venture capitalist by venture capital community, prior investees, personal acquaintances, banks and investment brokers.

Sweeting (1991) also found that most deals were referred by third parties and that venture capitalists rarely try to discover new investment opportunities proactively. As stated by Isaksson (2006), in a study by Engebretsen and Lundberg, seven Swedish venture capitalists were asked to estimate the main source of the business proposals they received. The two major sources for access to investment opportunities were the entrepreneurs themselves and the informal networks. Like in Sweeting (1991) and Tyebjee and Bruno (1984), a main conclusion was that venture capitalists almost without exception were applying a reactive, passive approach to deal generation. As per the study conducted by Sharma (2002) with respect to Indian venture capitalist, these venture
capitalists gave high priority to referrals or known potential investees whereas unsolicited calls by business plans were considered less important.

(b) Screening of Potential Investment Deals

Venture capitalists commonly receive many business proposals i.e. average 450 per year; as reported by Tyebjee and Bruno (1984) (Manigart et al., 1997) but, the rejection rate is very high; typically, only one out of every ten to twenty projects will pass the initial screening (Koh and Koh, 2002). Research has shown that for each project that is accepted, venture capitalists reject most of the proposals in the screening process (Mason and Harrison, 1999). The process used by the venture capitalists to filter out these proposals, is known as “Screening”.

Fried and Hisrich (1994) described that venture capitalists eliminate the proposals that are unable to meet the venture capital firms’ investment criteria, have been previously unsuccessful in certain sectors, and seem generally unpromising. Some quick and broad criteria are, thus, frequently used to select the deals that will be, later on, subjected to an in-depth evaluation.

Tyebjee and Bruno (1984) stated these criteria are size of the investment, investment policy of the venture fund, technology and market share of the venture, geographical location of the venture and stage of financing. MacMillan et al. (1985) in their studies reported that these criteria as necessary condition to weed out undesirable ventures at the initial stage only.

As reviewed above, all these studies in relation to deal generation and screening have simply focused upon locating the sources of potential deals and investigating broad criteria for preliminary screening. But in relation to India, there is a considerable gap in researching this area. The present study has examined various sources of deals as well as use of such deal sources classified as per the age of the firm i.e. already established venture capital firms, recently established venture capital firms and the firms that are in between these two categories. The study also checks upon the rejection rate of the proposals received and the reasons for the same.
2.1.2 Evaluation

After the initial screening, the proposals that look promising are scrutinized in detail at this stage. A number of researchers have studied the evaluation criteria used by the venture capitalists across different countries for example US (Tyebjee and Bruno, 1984; MacMillan et al., 1985; MacMillan et al., 1987; Hall and Hofer, 1993; Sandberg and Hofer, 1987; Zacharakis and Meyer, 1998) India (Pandey, 1996; Kumar and Vinay, 2002; Mishra A. K.,2005; Sharma, 2002), Taiwan (Pandey and Jang , 1996), South Korea (Rah et al., 1994), Central and Eastern Europe (Bliss, 1999; Karsai et al., 1998). As mentioned previously, Since 1970s most of the academic researchers tried to describe and understand venture capitalists’ decision making process and primary objective of these researches was to determine how venture capitalists can evaluate potential investments. These criteria generally relate to the quality of the entrepreneur/team, uniqueness of the product/service, attractiveness of the market as well as financial considerations (Tyebjee and Bruno, 1984; MacMillan et al., 1985; MacMillan et al., 1987; Hall and Hofer, 1993; Zacharakis and Meyer, 1998; Sandberg and Hofer, 1987).

Besides, the identification of selection criteria has been researched using different methodologies such as Factor and Cluster analysis (Tyebjee and Bruno, 1984, MacMillan et al., 1985, MacMillan et al., Hall and Hofer, 1993), Construct Analysis (Fried and Hisrich, 1994), Verbal Protocol (Zacharakis and Meyer, 1998, Sandberg and Hofer, 1987), Multi methods like Case Analysis, Published Interviews, Questionnaire, Personal Interviews, Administrative Records; to enhance the understanding of investment criteria and also extend it to other aspects of investment process like deal structuring and divestment (Mishra, 2005). A few of these studies conducted in this regard have been reviewed here in detail.

Tyebjee and Bruno (1984) investigated the factors influencing the investment evaluation of venture capital funds in the US. The authors found that the evaluation factors clustered into five categories: i) Market Attractiveness (i.e. size, growth, and access to customers), ii) Product Differentiation (i.e. uniqueness, patents, technical edge, profit margin), iii) Managerial Capabilities (i.e. skills in marketing, management, finance and the references of the entrepreneur), iv) Environmental Threat Resistance (i.e. technology life cycle, barriers to competitive entry, insensitivity to business cycles and down-side risk
protection), and v) Cash-Out Potential (i.e. future opportunities to realize capital gains by merger, acquisition or public offering).

Macmillan *et al.* (1985) conducted a formal follow-up study to one by Tyebjee and Bruno (1984) and identified 27 criteria grouped into six categories namely, entrepreneur's personality, entrepreneur's experience, product characteristics, market characteristics, financial considerations and composition of the venture team, for the venture investment evaluation. The most important finding from the study is direct confirmation of the frequently iterated position taken by the venture capital community that above all it is the quality of the entrepreneur that ultimately determines the funding decision.

MacMillan *et al.* (1987) pointed out how successful ventures are distinguished from unsuccessful ventures by screening 150 ventures as per five major classes of criteria. An important finding is the identification of two major criteria that are predictors of venture success. These are the extent to which the venture is initially insulated from competition and the degree to which there is demonstrated market acceptance of the product.

Studies by Bliss (1999) and Karsai *et al.* (1998) reviewed the evaluation criteria used by the local venture capitalists across the CEE region and observed certain differences. Karsai *et al.* (1998) reported that in Hungary and Slovakia, venture capitalists focus more on the evaluation of market opportunities, while entrepreneurial skills and a strong track record are the key focus areas for venture capitalists in Poland. Bliss (1999) validated the importance of evaluating external factors, especially the country’s legal and fiscal infrastructure. Both these studies in the region reinforce the importance of a return potential (i.e. return on investment).

A study by Rah *et al.* (1994) explored the investment evaluation criteria of Korean venture capitalists. The top six factors identified by them are: managerial capability, market attractiveness, superiority of product and technology, financing ability, availability of raw materials and production capability.

As reported by Pandey and Jang (1996), Ray and Ray and Turpin analysed the investment evaluation criteria used by venture capital funds, respectively, in Singapore and Japan. In both Singapore and Japan, the entrepreneur's personality and experience
were found to be the most important aspects of evaluation, and financial considerations as the least important in venture investment evaluation. Similar results have been obtained by Pandey (1996) for venture capitalists in India.

Pandey and Jang (1996) examined the criteria used by venture capitalists in Taiwan for the evaluation of ventures. As per this study the five most substantial evaluation criteria used by the venture capitalists in Taiwan are: return on investment, entrepreneur's technical skills, market need for product, growth potential of market, and investment to be easily liquid. While five relatively least important evaluation criteria are: uniqueness of product, creation of a new market, no exception on making subsequent investments, track record relevant to the venture, government regulations and protection from competitive entry. Table 2.1 summarises the five top most frequently rated evaluation criteria by the venture capitalists; across, US, Singapore, Japan and India.

<table>
<thead>
<tr>
<th>Criteria</th>
<th>US</th>
<th>Singapore</th>
<th>Japan</th>
<th>India</th>
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<tbody>
<tr>
<td></td>
<td>1995</td>
<td>2003</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Sustained intense effort</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>*</td>
</tr>
<tr>
<td>Familiar with target market</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>*</td>
</tr>
<tr>
<td>Evaluates and reacts to risk</td>
<td>5</td>
<td>5</td>
<td>3</td>
<td>*</td>
</tr>
<tr>
<td>Demonstrated leadership</td>
<td>4</td>
<td>2</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>At least 10 times returns in 5-10 years</td>
<td>4</td>
<td>5</td>
<td>*</td>
<td>*</td>
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<tr>
<td>High market growth rate</td>
<td>*</td>
<td>2</td>
<td>4</td>
<td>5</td>
</tr>
<tr>
<td>Creation of a new market</td>
<td>*</td>
<td>*</td>
<td>5</td>
<td>*</td>
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<tr>
<td>Liquid investment</td>
<td>*</td>
<td>*</td>
<td>5</td>
<td>*</td>
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<tr>
<td>Integrity</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>1</td>
</tr>
<tr>
<td>Managerial skills of venture team</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>2</td>
</tr>
<tr>
<td>Functioning prototype</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Urge to grow</td>
<td>*</td>
<td>5</td>
<td>*</td>
<td>3</td>
</tr>
<tr>
<td>Long term vision</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>4</td>
</tr>
<tr>
<td>Commercial orientation</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>5</td>
</tr>
<tr>
<td>Attention to detail</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>5</td>
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</table>

Asterisk (*) indicates the factors not among the 5 top most criteria


Indian studies on evaluation criteria have been discussed later in this chapter. All the above mentioned studies have employed either structured questionnaires or structured
interviews as their data collection methods. The previous studies typically ask venture capitalists to list and rank decision criteria that affect their investment decisions. The argument that the venture capitalists are not good at exactly recalling the decision-making criteria while filling up the questionnaire or while being interviewed is picking up (Kumar and Kaura, 2003). Hence, they may suffer from a systematic bias which obstructs their investment portfolio (Zacharakis and Meyer, 1998). There are studies by Sandberg and Hofer (1987), Hall and Hofer (1993) and Zacharakis and Meyer (1998); that have applied different approach and methodology (like Verbal Protocol and Social Judgment Theory) to overcome prior post hoc study flows by using verbal protocols. The problem with these studies is that they point out the need for collecting real time data of venture capital’s decision, but they do not seem to report any new real time criteria. The studies that used verbal protocol also came up with the criteria earlier reported by the previous studies. However, the studies based upon the verbal protocol and social judgementive theory are significant as they pave the way for further inquiry which may enable future research to come up with newer findings (Kumar and Kaura, 2003). The major findings of these studies have been highlighted below.

Sandberg and Hofer (1987) examined the determinants of new venture performance using a qualitative technique called verbal protocol and reported the same criteria but with a different approach. As per the study results, industry structure had a greater impact on new venture performance than either strategy or the characteristics of the entrepreneur.

The study by Hall and Hofer (1993) uncovered the criteria used by venture capitalists through semi structured interviews and verbal protocol analysis. The findings of this study suggested that venture capitalists screen and assess business proposals very rapidly. Findings of this study were surprising for the lack of importance venture capitalists attached to the entrepreneur/entrepreneurial team and the strategy of the proposed venture during these early stages of the venture evaluation process.

Zacharakis and Meyer (1998) used a social judgment theory from cognitive psychology and applied a tool called policy capturing to the problem of venture screening. The findings of this study suggested that venture capitalists are not good at introspecting about their own decision process. Due to information overload while making decision, it
might be difficult for venture capitalists to truly understand their own intuitive decision making process. A brief summary of the selective studies on evaluation criteria used by the venture capitalists is presented in the following table.

Table 2.2 Summary of Selective Studies on Evaluation Criteria used by Venture Capitalists

<table>
<thead>
<tr>
<th>Study</th>
<th>Method/Data</th>
<th>Sample</th>
<th>Statistical Analysis</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tyebjee and Bruno (1984)</td>
<td>Telephonic Interview</td>
<td>46 VC firms</td>
<td>Regression, factor and discrimination</td>
<td>US</td>
</tr>
<tr>
<td>MacMillan, Siegel and Narshimha (1985)</td>
<td>Questionnaire</td>
<td>102 VC firms</td>
<td>Factor and cluster analysis</td>
<td>US</td>
</tr>
<tr>
<td>Sandberg and Hofer (1987)</td>
<td>Interview</td>
<td>3 Interviews</td>
<td>Verbal protocol</td>
<td>US</td>
</tr>
<tr>
<td>Hall and Hofer (1993)</td>
<td>Semi-structured Interview</td>
<td>4 VC firms</td>
<td>Verbal protocol</td>
<td>US</td>
</tr>
<tr>
<td>Pandey and Jang (1996)</td>
<td>Questionnaire</td>
<td>20 VC Funds</td>
<td>Mean, standard deviation and rank</td>
<td>Taiwan</td>
</tr>
</tbody>
</table>

The entire literature on evaluation criteria used by the venture capitalists can be summed up with an observation that the said research is split between two categories. One category comprises of researchers who argue that in contemplating their investment decision venture capitalists mostly rely on the criterion of management capability (Macmillan et al., 1985; Rah et al., 1994; Hall and Hofer, 1993) and second category comprises of those who propose that market size, growth rate and product quality play a more important role than management capability (Zacharakis and Meyer, 1998; Tyebjee and Bruno, 1984).

As MacMillan et al., (1985) summarize their findings: “there is no question that irrespective of the horse (product), horse race (market), or odds (financial criteria), it is the jockey (entrepreneur) who fundamentally determines whether the venture capitalist
will place a bet at all.” In-depth studies, however, show that management capability is typically coupled with some other important criteria, such as market size and growth rate as well as competition.

From the above analysis of the literature on the venture capital evaluation criteria, it may be concluded that researchers have made an extensive efforts in this area applying different methodologies from simple questionnaires and interviews to verbal protocol analysis, across developed as well as developing countries. In the present study, once again the venture capitalists’ evaluation criteria have been investigated in Indian context by obtaining a larger and more representative sample.

2.1.3 Deal Structuring

In the process known as deal structuring, both these parties i.e. the venture capitalist and the entrepreneur negotiate the terms of the deal including the amount, form and price of the investment (Pandey and Jang, 1996). Conflicts between the venture capitalist and the entrepreneur may arise due to differing expectations about the role each party is expected to have and these roles are subject to contracts. Hence, the initial contract is intended to create a mutual understanding between the parties and thus may be regarded as a basis for successful co-operation. This justifies the time spent on negotiation and contract writing in the venture capital investment process (Isaksson, 2006).

The academic literature relating to venture capital contracting is significant. Gompers and Lerner (1999) observed that high technology investments with a higher risk of failure generally entail more contract provisions related to milestones as compared to low-technology companies. Sahlman (1990) summarized the common governance structures that typify the venture capital industry. Kaplan and Stromberg (2003) provided an overview of the extent of specific governance methods that are commonly applied in venture capital finance. As per the study, if companies lack significant turnover, venture capitalists apply staging mechanisms, vesting, voting rights and board influence in order to supervise the investment effectively. However, venture capitalists tend to release these stringent conditions the more the venture matures and the more the uncertainty is resolved.
Gompers (1995) explored the periodic reviews by venture capitalists and suggested that staged capital infusion is important in minimizing agency costs. In venture capital investment, capital and competence are transferred from the venture capitalist to the entrepreneurial firm in the value adding phase and the transformation of capital can be seen as the final ending of the investment decision phase. However, all capital is not provided at once, rather through stages; often according to predefined milestones (Kiholm and Smith, 2000). Sahlman (1990) observed that through this multi-stage structure, the venture capitalist will have more control over management and the operation of the portfolio business.

The venture capital industry has developed control mechanisms to deal with incentive problems in an uncertain environment. The primary control means, being use of security and covenants (control areas), have been discussed further in this section.

2.1.3.1 Use of Security/ Instrument of Financing

Venture capitalists use a variety of forms of finance, including common equity, warrants, straight preferred, convertible debt, straight debt, and combinations of each form of finance. However, various studies provided empirical evidence for the use of convertible securities in venture capital contracts (Gompers, 1997; Kaplan and Strömberg, 2003; Bascha and Walz; 2001). Preference for use of convertible preferred securities centers on asymmetric information, incentive problems, and taxes (Denis, 2004).

The choice of convertible preferred equity provides the proper intervention incentives and the optimal insurance for the venture capitalist. Using convertible securities allows for more ex post flexibility in the (re-) allocation of control rights and the right to decide on exit. Furthermore, it provides for the holders of convertible securities (either convertible debt or convertible preferred stock) a protection against the downside risk of investments by providing seniority rights over straight equity (Schwienbacher, 2005). Cornelli and Yosha (2003) observed that when the venture capitalist retains the option to abandon a project through the staging of capital, the entrepreneur has the incentive to manage earnings for subsequent financing round. With convertible securities, this earnings manipulation increases the chances that the venture capitalist will convert into equity, thereby diluting the entrepreneur’s claim. As a result, the use of convertibles
reduces the entrepreneur’s incentive to engage in short-term earnings management (Denis, 2004).

In the US, venture capitalists typically invest in startup companies by purchasing convertible preferred stock (Norton and Tenebaum, 1992). Sahlman (1990) and Gompers (1997) also validated this finding and reported systematic preference for convertible preferred stock in their studies. Sahlman (1990) hypothesized that the most important role of convertible securities is to properly align the incentives of entrepreneurs and venture capitalists and to provide information about the entrepreneur.

Cumming (2007) reported that the preference for convertible preferred applies to US but does not extend to Canada. Isaksson (2006) described that Swedish venture capital firms do not seem to have adopted that custom of investing through preferred stock like venture capitalists in US. As stated by Zacharakis and Eckermann (2007), Cumming and Gilson and Schizer argued that significant tax advantage for convertible preferred equity motivates US venture capitalist to favour such financing means. Besides, preferred stock can be seen as less risky than equity capital as in case of preferred stock, the holders have preferential rights to dividends in case of bankruptcy or that they have favourable dividend terms than other shareholders (Bascha and Walz, 2001).

2.1.3.2 Covenants

In covenants, control rights are assigned to the investors over actions that are particularly damaging to them. Covenants thus establish the basis under which the venture capitalist can take control of the board, force a change in management or liquidate the investment by forcing a buy-back, a merger, acquisition or public offering even though the venture capitalist holds a minority position. The covenants may also restrict the power of the venture management to dilute the equity of the original investors by raising additional capital elsewhere (Pandey and Jang, 1996 and Tyebjee and Bruno, 1984) As per Smith and Warner’s (1979) analysis of bond covenants, writing contracts is costly and parties negotiating certain restrictions will include them only when benefits from restricting activities outweigh costs of contracting and monitoring compliance. The greater the potential for agency conflicts, the more likely restrictions will be imposed.
Similarly, Gompers and Lerner (1996) found that potential agency costs explain some of the covenant inclusion in venture capital limited partnership agreements. The greater the likelihood for conflicts between venture capitalists and their investors leads to tighter covenants in the venture capital limited partnership. Kaplan and Strömberg (2003) concluded that there was a high degree of standardization in the contractual covenants used in venture capital agreements. Hatherly et al. (1994) identified a range of areas where the control is exercised by investors by means of venture agreement. These include: dividend payment levels, participation in mergers, sale of assets, debt levels, capital expenditure, management remuneration, working capital maintenance and hiring of employees.

This study has investigated the choice of security i.e. equity, debt, convertible securities and various areas/operations of the investee companies controlled by the venture capitalists in the Indian context. For study of covenants, the areas as defined by Hatherly et al. (1994) and as stated above have been applied.

2.1.4 Post-Investment

One of the distinguishing features of venture capital, as against the traditional forms of financing, is the active involvement and the assistance by the venture capitalists to the investee companies. Through the process, the venture capitalist works with the entrepreneur to resolve any problems where the management may lack the direction (Ruhnka et al., 1992 and Gorman and Sahlman, 1989). This monitoring and assisting is referred to as value adding (Zacharakis and Eckermann, 2007).

Ability of the venture capitalist to impart critical knowledge and experience in addition to funding may be instrumental in the portfolio firm’s subsequent success or even survival (Gorman and Sahlman, 1989; Macmillan et al., 1989; Sapienza, 1992; Sapienza et al., 1996; Hellmann and Puri, 2002). The approach focusing on the post-investment contribution of venture capitalists has its roots in resource-dependence logic. This perspective on venture capital research, views the venture capitalist as a provider of resources beyond the capital (Berg-Utby et al., 2007). Past research on the venture capitalist role as a resource provider has identified their most common forms of support as: serving as a sounding board for the venture; strategic advice; general business
knowledge; and networks. The literature in relation to these value adding activities has been reviewed in the following part.

Several studies have indicated that, in addition to providing capital, venture capitalists perform many other roles in their portfolio companies (Timmons and Bygrave, 1986; Gorman and Sahlman, 1989; MacMillan et al., 1988; Maula et al., 2005; Dolvin, 2005; Ehrlich et al., 1994; Busenitz, 2004; Gabrielsson and Huse, 2002; Sweeting and Wong, 1997; Gomez-Mejia, 1990). In general, two approaches have been taken by researchers on the issue of value addition by the venture capitalist. One approach concerns the influence of venture capitalists on the financial performance of the portfolio ventures, while the other has been to measure the perceptions of value added from the perspectives of both the entrepreneur and the venture capitalist (Sapienza, 1992).

Scholars analysed the scope of the venture capitalists’ non-financial contribution to the venture and found that venture capitalists typically assist on financial and managerial problems (MacMillan et al., 1989; and Sahlman, 1990). Further, Gorman and Sahlman (1989) and Hellman and Puri (2002) added that venture capitalists help in recruiting top management. Using a sample of 173 startup companies located in California’s Silicon Valley, Hellman and Puri (2002) found that companies that obtain venture capital are more likely to professionalize along several dimensions like human resource policies, the recruitment of professional marketing and sales staff, and the adoption of stock option plans.

In a separate study, Hellman and Puri (2000) reported that venture capital backed firms tend to bring their products to market more quickly. These findings are consistent with the view that the expertise of venture capitalists gives the companies a comparative advantage in identifying valuable innovations and assisting the companies in bringing their product to market.

Venture capitalists are often represented on the board of directors of their investee companies and strategic advice is one of the most cherished contributions that they make (Gorman and Sahlman, 1989; Manigart and Struyf, 1997). Venture capitalists in the US are found to be vigorous and influential board members (Rosenstein, 1988). Various board roles are described in the literature and for that agency and resource based
arguments have given the rationale for the board’s involvement in various roles (Gabrielson and Huse, 2002). Representation on the board of the portfolio firm may be a way for the venture capitalists to safeguard their largely unprotected investment. There are basically three views related to the functional duties of the board. They relate to the resource dependency function, governance function, and the board’s contribution to the strategic decision-making processes (Wijbenga et al., 2003).

In addition to providing monitoring and other support services to entrepreneurial firms, venture capitalists can potentially help entrepreneurs raise additional funds by certifying the quality of a startup (Dennis, 2004). Research has also paid special attention to the certification role of the VCs in initial public offerings (IPOs) (Megginson and Weiss, 1991; and Dolvin, 2005). Venture capital backed firms are found to avoid under-pricing (Megginson and Weiss, 1991) and receive higher valuations at the time of IPO. Furthermore, venture capital backing is found to be associated with lower issuance costs (Dolvin, 2005; Megginsson and Weiss, 1991) and perform better than non-venture-backed firms in the time after the IPO.

Timmons and Bygrave (1986) found that the “capital” in venture capital is the least important ingredient in fostering technological innovation. Qualities commonly cited by entrepreneurs of the venture capitalists in this study included helping to find the select key management-team members; providing credibility with suppliers and customers; and helping to shape strategy.

MacMillan et al. (1989) reported that activities attracting the highest degree of venture capitalists’ involvement were: serving as a sounding board to the entrepreneur team, helping the firm obtain alternative further sources of equity financing, interfacing with the investor group, monitoring financial performance, monitoring operating performance, and helping their portfolio firms attract alternative sources of debt financing. Similarly, Gorman and Sahlman (1989) documented a ranked order of the forms of assistance as help with obtaining additional financing; strategic planning; management recruitment; operational planning; introductions to potential customers and suppliers; and resolving compensation issues. Maula et al. (2005) have compared systematically the value added (social capital based and knowledge based) provided by venture capitalists and corporate venture capitalists. They observed that the independent venture capitalists add value in
helping raise additional finance, recruiting key employees and professionalizing the organization.

Summarizing from the results of earlier studies, the most value-adding services of independent venture capitalists, other than the initial provision of capital, are likely to involve arranging additional financing, supporting strategic decision making, monitoring operational and financial performance and finally recruiting key executives. All these services serve to ensure that the young firm can respond rapidly and effectively to the entrepreneurial opportunities that the firm has identified.

Further, MacMillan et al. (1988) observed that the venture capitalists were involved in developing production or service techniques of the portfolio companies, but this was the least significant form of contribution they made. The results of the study by Murray (1996) also revealed the similar findings. As per the findings, nature of the venture capitalist’s advice and intervention was rarely associated with the technical details of the specific innovation even though a number of investors had a technical background in the appropriate discipline. Despite that external know-how regarding product and research development may be of value to the new firm, previous research suggested that VC involvement in these activities is generally on a limited scale.

Researchers further analysed the intensity of the venture capitalists’ involvement. Gorman and Sahlman (1989) found that venture capitalists spend 60% of their time on post-investment activities. On an average, venture capital commits 110 hours per year to assisting and monitoring one venture investment. They also reported that lead venture capitalists visit companies in their portfolios an average of 19 times per year. Elango et al. (1995) reported that venture capitalists devote on an average 20 hours per month in monitoring every portfolio company. However, the level of interaction between the entrepreneur and the venture capital may vary. Tyebjee and Bruno (1984) stated that intensity of involvement in the venture's operations differs from one venture capitalist to another. They further observed that it was undesirable for a venture capital fund to exert control over the day-to-day operations of the venture. If a financial or managerial crisis occurs, the venture capitalist may intervene and even install a new management team.
While venture capitalists’ participation in an investee firm varies from deal to deal, new ventures require more assistance than developed businesses (Sapienza, 1992; Sweeting, 1991). Venture capitalists are, in general, expected to increase their activities and add more value to ventures in the earliest stages when business risk is high (Sapienza et al., 1996). Sapienza and Gupta (1994) examined how context impacts the level of venture capital involvement. As per their findings, venture capitalists’ involvement tends to be lower when the venture capitalist has less experience, the venture capitalist is geographically distant to the venture and the venture capitalist perceives high goal congruence with the entrepreneur. Furthermore, Sapienza, Manigart and Vermeir (1996) found that monitoring and value added activities increase based on the need of the portfolio company moderated by the venture capital’s experience. More experienced venture capitalists provide greater value added services.

Thus, studies examining the relationship between entrepreneurs and venture capitalists, as viewed from the venture capitalists’ perspective, have focused on the research areas like degree of involvement of venture capitalists in portfolio companies, the relationship between stage of investment and degree of involvement, identification of high and low investor-involvement activities, and the relationship between investor involvement activities and firm performance.

Most research on investor involvement has centered on the venture capitalists. The scholars in this area have focused on the venture capitalist as the primary investor. The investees who are the recipients not only of the financing but also of the monitoring, control and management contributions of the venture capitalist's activities, have not been focused much upon by the researchers (Sweeting and Wong, 1997). From the perspective of the portfolio firm, this ability to provide value-adding services constitutes an even more important selection criterion than their willingness to provide funding for the firm (Maula, 2005). Selective studies focused upon the entrepreneur have been reviewed as below.

Ehrlich et al. (1994) reviewed two studies for the involvement of venture capitalist from the entrepreneur’s perspective, carried out by Rosenstein and other researchers in 1989 and 1990. In the first study in 1988, Rosenstein et al. adapted survey instrument of MacMillan et al. (1988) and surveyed 162 CEOs for the extent and usefulness of venture
capitalists’ involvement on the firms’ boards of directors. The CEOs reported five most important areas of venture capitalists’ involvement to include serving as a sounding board to the management team, interfacing with the investor group, monitoring financial and operating performance, and recruitment/replacement of the CEO. This study recognized gaps between effort and usefulness (where CEOs perceived that venture capitalists’ efforts were greater than their usefulness) in three specific areas i.e. monitoring operating performance, monitoring financial performance and formulating marketing plans. In the second study (follow-up) by Rosenstein et al. in 1990, CEOs reported that activities of highest involvement included serving as a sounding board, interfacing with investor groups, and monitoring financial performance, respectively.

Sapienza and Timmons (1989) collected survey data from 51 venture capitalist-entrepreneur dyads. The purpose of the study was to determining the importance that venture capitalists and entrepreneurs place on various roles assumed by venture capitalists in ventures they fund and to understand what factors influence the importance of these roles. From the perspective of both venture capitalists and entrepreneurs, the study reported high importance roles as serving as a sounding board and business consultant, moderately important roles as coach/mentor, financier, and friend/confidant and finally low importance roles as management recruiter, industry contact, and professional contact.

Again there are very few studies examining the differences in the perceptions of venture capital funds and the investee companies about the venture capitalists' involvement and the investee companies' perceived level of satisfaction. One such study by Pandey and Jang (1996) described that the perceptions of the investee companies on the degree of involvement were lower than that of the venture capital funds in the areas like suggesting operating strategies, providing consulting services, involvement in the board of directors, assisting in product planning, providing market information, providing capital and help in designing financial strategies.

The study by Berg-Utby et al. (2007) took a different approach by comparing the pre-investment expectations and post-investment perceptions of the new venture teams regarding the value addition by the venture capitalists. This study shows that the portfolio firms of Norwegian venture capital firms seem to have quite moderate
expectations regarding the value added contributions from their venture capitalists. An intriguing finding from this study is the significant gap between an entrepreneur’s pre-investment expectations and what they perceive to be the actual contributions from their venture capital backers. Entrepreneurial views which consider that venture capitalists do not meet their expectations are significantly present in all resource categories like product development, marketing, strategy, management accounting and further finance. So, even though the expectations can be considered to be quite modest in all five resource areas, venture capitalists do not meet the portfolio firms’ expectations. Selective studies on value added by the venture capitalist have been summarized in the form of a table. The same has been annexed at the end of the thesis (Refer Appendix A).

Despite the above mentioned research in the area of venture capitalists contribution to the investee firm from both the perspectives, there is no conclusive evidence as to whether such involvements add value to the investments (Busenitz et al., 2004; Mason and Harrison, 1999; Rosenstein et al., 1993; Sapienza, 1992). Many researchers have found that active involvement of venture capitalists adds value to their investments (e.g. Gorman and Sahlman 1989, MacMillan et al. 1989, Sapienza et al. 1996). However, very few have managed to empirically show that this value adding has an effect on business performance (MacMillan et al., 1988; Sapienza, 1992; Sapienza et al., 1996; Sweeting, 1991). In fact, there are studies that show that the degree of involvement by the venture capitalist is actually negatively related to business performance (Gomez-Mejia et al. 1990).

One explanation for this might be that venture capitalists tend to react only when they are needed, indicating that venture capitalists are more involved in the poorly performing firms in their portfolios. When Manigart et al. (2002) examined the long term effect of venture capital involvement by comparing the survival rate of 565 Belgian venture capital backed firms and 565 comparable firms, they found that venture capital backed firms do not have a higher probability of surviving than comparable non-venture capital backed firms.

Brau et al. (2004) compared the performance of 126 venture capital backed firms after their initial public offering (post-IPO performance) with a control sample of non-venture capital backed firms, and found no significant differences between firms financed by
venture capitalists and without venture capital support. Gomez-Mejia et al.'s (1990) study concluded that CEOs viewed the financial and networking activities as valuable, but gave mixed reviews to the value of the managerial involvement of venture capitalists, with many CEOs viewing managerial intervention as counter-productive. Thus, the common wisdom that venture capitalists in general add value is challenged by few researchers.

To summarize, the literature on post-investment activities of the venture capitalist shows that venture capitalists provide many benefits to entrepreneurial companies that are not normally provided by financial intermediaries. Of course, these benefits are not costless to entrepreneurs. Venture capitalists tend to demand high rates of return for their investments relative to other private equity investors (Sahlman, 1990). This makes venture capital a relatively expensive source of financing. These costs must be traded off against the benefits of venture capital financing (Dennis, 2004).

This study takes a broader perspective wherein the involvement of the venture capitalist has been investigated from both the perspective i.e. Supply side; venture capitalists and the demand side; entrepreneurs. On supply side, the study explores the involvement of Indian venture capitalists in different areas/activities of the investee companies they fund. On the demand side, the study investigates the differences in the pre-investment perceptions of the investee companies and the post-investment actual contribution of the venture capitalist as perceived by the entrepreneurs in Gujarat. And for this purpose, the research instrument used in the study of Berg-Utby et al. (2007) has been adapted. Further, for examining the monitoring, the study concentrates upon the methods used for exercising control by the Indian venture capitalists (i.e. continuous monitoring, conformance to the objectives as set in the plan, evaluation of management); means of formal monitoring (i.e. budgets, business plans, monthly accounts and financial statements); methods for collection the information from the investee companies (i.e. Telephone conversation, personal visit, management reports, and board meetings); the frequency of performance review and the number of visits to the investee companies (i.e. monthly, quarterly, half yearly and yearly).
2.1.5 Exit

The exit denotes the process in which the venture capitalist converts illiquid stakes in a venture into cash or liquid stakes which it can subsequently return to the limited partners (Zacharakis and Eckermann, 2007). Given the non existence of interim dividends in early stages, venture capital exit may be the only source of gains (Black and Gilson, 1998). Even though exit strategies intuitively are placed as the last part of the process, they are considered throughout the investment period. This exit can be done in several ways, for instance by an initial public offering, acquisition, buyback or, in a worst-case scenario, by a write off (Cumming and MacIntosh, 2002).

Venture capitalists typically aim at making medium to long term capital gains. A venture capital company has, almost by definition, a time limit for the investments they enter. The time horizon can be in the range from 3-4 years up to 10 years, usually depending upon the venture capitalist’s investment strategy (Bygrave and Timmons, 1992). Gompers (1995) provided evidence that the degree of asymmetric information has a significant impact on the time-to-exit. This implies that early stage investments require a longer lasting involvement of venture capital funds than later-stage investments.

Research that focuses on venture capital exits is dominated by studies of IPO exits because of the preference of the venture capitalists for this exit mechanism. It is undeniably the most profitable and, hence, most desirable exit. As per Bygrave and Timmons (1992), IPO exits generated almost five times greater profits than the second most profitable exit mechanism, acquisition by another firm. Furthermore, additional data collection for other exit options is complex increasing the likelihood that exit research would be dominated by an IPO (Isaksson, 2006). Investee firms generally favor a public offering because it preserves the independence of both the firm and the entrepreneurs, in addition to providing the firm with continued access to capital. For venture capitalists, a public offering rarely concludes their relationship with the investee firm, as the underwriters can prevent venture capitalists from disposing of all shares at the time of an IPO. Private sales, in comparison, will almost certainly end a venture capitalist’s involvement with the investee firm (Pandey and Jang, 1996).
The prominent work in the area of venture capital exit is by Cumming and MacIntosh (2001, 2002, 2003), on exit mechanism and strategies in US and Canada. Their research provides a general theory of venture capital exits. As per the theory, a venture capitalist will exit from an investment when the projected marginal value added as a result of its efforts, at any given measurement interval, is less than the projected marginal cost of these efforts.

Importance of various factors that may influence the duration of a venture capital investment was analysed by Cumming and MacIntosh (2001). They developed a simple theoretical model to analyze the optimal duration of the venture capital investment. They reported that portfolio firm’s stage of development and the availability of capital to the venture capital industry were found to shorten the average investment duration.

Cumming and MacIntosh (2002) explored whether there exists an optimal pattern of exit depending on the quality of the investee firm, the nature of its assets and the duration of the venture capital investment. They concluded that IPO are the most important exit form for high quality firms. In a study by Cumming and MacIntosh (2003), they found that venture capitalists use partial exits to grant follow-on investors insight into the value of the company in cases of severe information asymmetries.

Schwienbacher (2005) studied venture capital exits in Europe and in the US and found that although there were numerous similarities between exit behaviour in US and Europe, there were also important differences, in particular with respect to the duration of exit stage (the exit stage is longer in the US), the use of convertible securities (more used in the US), the replacement of former management (are more often replaced in the US) and deal syndication (deals are more often syndicated in the US). They suggested that most of these differences could be explained by the less liquid markets that European venture capitalists face. The major difference between European and US venture capitalists when it comes to exit route preferences is that US venture capitalists show a higher strict preference for IPOs, while European venture capitalists show a higher strict preference for trade sales.

Felix et al. (2008) analysed the exit decision in the European venture capital market. As per the results, European venture capitalists associated with financial firms have faster
exits for all exit forms. This result is stronger for trade sales exits, suggesting that in Europe, venture capitalists associated with banks have larger network of contacts, which facilitates the task of finding potential buyers in trade sales exists.

Isaksson (2006) noted that Swedish research on venture capital exits is very limited and that trade sales have been the most used exit mechanism in Sweden, with an exception of a couple of years in the late 90s when IPOs where more common. Farag et al. (2004) confirmed the trade sale as the most viable exit channel in the Central and Eastern Europe region.

As per the study by Pandey and Jang (1996), commonly-used exit vehicle for venture capital funds in Taiwan is initial public offerings (IPOs) followed by secondary purchase and repurchase of shares by the investee company. It is difficult for high technology firms to go public through stock exchanges in Taiwan as there are numerous stringent listing conditions, especially in terms of the minimum capital and profitability requirements. For this reason, Taiwan has now provided a separate listing category with a few listing requirements for high-technology small- and medium-size firms.

Das, Jagannathan, and Sarin (2003) observed that the likelihood of a trade sale increases with the stage of development as many early staged firms that were unable to make it to the IPO stage settled for a buyout. Analysis by Giot and Schwienbacher (2006) suggested an exit order (IPO, and then possibly a trade sale) that is consistent with the fact that venture capitalists first target the IPO as the preferred way of cashing out on investments. Because the window of opportunity for trade sales extends for a considerable amount of time, trade sale exits are second-best choices available for an extended amount of time.

Various studies in relation to venture capital exit as discussed above mainly relate to the exit options in the context of different countries. In the present study, various exit options as mentioned before in this section and the time frame for exit have been investigated in Indian context.

Apart from the pre-investment, investment and post-investment stages in the venture capital process, various other aspects like geography of venture capital financing, incubation, angel investment, bootstrapping techniques and syndication of venture
capital investments investigated in the thesis and the literature in relation to these topics has been discussed briefly in the following section.

2.2 Geography of Venture Capital Financing

Geographical mismatch between the supply of, and demand for, venture capital arises from the geographical concentration of venture capital funds and investment in certain regions. As per Mason (2007), this uneven geographical distribution of venture capital investments can be attributed to some major factors like Clustering of venture capital firms and the localized nature of venture capital investing. Very few studies have introduced the analysis of distance into the field of venture capital research. Mason and Harrison (2002) reported that the existing literature on the geography of venture capital largely relates to the 1980s, when the venture capital industry was in its early growth stage in the US and in its infancy elsewhere. In the US several studies investigating the geography aspects of venture capital were published at the end of the 80’s and the beginning of the 90’s (Makra and Malovics, 2006). This clustering of venture capital financing has also been studied with respect to other countries like UK, and India in addition to US.

The geography of venture capital financing follows certain pattern depending upon various favourable environmental factors like political, economic, and technological. The findings of various studies conducted across different nations support this observation. The inaugural study of the geography of venture capital financing in the US revealed that there are technology-related (Silicon Valley and Boston) as well as finance-related (New York) clustering (Dossani and Kenney 2001; Florida and Kenney, 1988a and b). Similarly in the UK also there exists both technological and financial clustering. Until 1980s, most VC clustering took place in Greater London and the South East but subsequently, due to “merchant” venture capital financing, this concentration was reduced considerably (Mason and Harisson, 2002). In India also concentration of venture capital firms is more in Bombay (Finance-related cluster), New Delhi (Political-related cluster), and Bangalore (Technology-related cluster) (Dossani and Kenney, 2001).

Further, Subhash (2007) analysed the geography of venture capital financing in Canada during a period of 1993-2005. Ontario, Quebec and British Columbia have major
concentration of VC investment due to favorable technology, finance and political clustering in these regions.

Makra and Malovics (2006) observed that all active venture capital firms with offices in Hungary can be found in the Central Hungary Region in Budapest. As it is the political and economic centre with by far the most advanced business infrastructure (special law offices, consultants and financial institutions) in Hungary.

Literature on the localized nature of venture capital investing suggests that venture capitalists favour businesses that are located close to where the venture capitalists, themselves are located. As per Florida and Smith (1993), venture capital firms located in high tech clusters tend to restrict their investment to the cluster. Powell et al. (2002) reported that just over half of all bio-tech firms in the US. attracted venture capital investment from the local sources. Martin et al. (2005) observed a strong tendency of German venture capital firms to invest locally.

As observed by Zook (2004), over the period 1988-99, more than half of the US. biotech firms received locally-based venture funding. He reported that the proximity to investee helps venture capital firm in generating the deal flow, evaluating the deal and maintaining post-investment relationship with the investee. Similarly, as venture capital firms grow older and bigger, they invest in more non local firms. Increased size and greater experience could also provide venture capital firms with the capability to support more distant firms.

As venture capital investment is a relational investment requiring a close contact with the portfolio firm, local investing would facilitate achieving this purpose. The venture capital investment outcomes show clear evidence of spatial proximity effects; investment is disproportionately concentrated in those regions that also contain the major clusters of venture capital firms (Martin et al., 2005). Mason and Harrison (1999) has aptly wrote that venture capital firms typically also adopt a “hands on” investment style in order to limit risk and add value to their investments, requiring close contact to be maintained with investee companies. Investors located near a firm can visit the firm’s operations, talk to suppliers and employees, as well as assess the local market condition in which the firm operates (Tian, 2008).
Considering the scope of the geography of venture capital investing, this study analysed geographical preference of venture capitalists for investment in India. Venture capitalists in India were asked to rate the importance of proximity to the portfolio companies. The study also crosschecked with the entrepreneurs from Gujarat, about their locational preferences for raising the funds from the venture capitalists.

2.3 Venture Capital Syndication

Syndication of venture capital investment is one of various strategies to deal with high risk environment developed by venture capital firms (Manigart et al., 2002; Wright and Robbie, 1998). An equity syndicate involves two or more venture capital firms taking an equity stake in an investment, either in the same investment round or more broadly defined at different points in time (Brander, Amit and Antweiler, 2002). Syndication is a common practice in North America and Europe. As per the Statistics of European Venture Capital Association (EVCA), almost 30% of the amount invested by the venture capitalists and the number of deals were syndicated in 2001. While syndication practices in U.K. and Netherlands are low both in terms of amount invested as well as number of deals as a result of continual decreases in syndicated activity throughout 1990s (Manigart et al., 2002). However, the formal academic literature on venture capital syndication is modest in scope. Despite the importance of syndication activity in the venture capital sector, little is known on the motives for syndication.

One rationale for syndication, suggested by Lerner (1994), is related to selection hypothesis at a pre-investment stage. The evaluation of the same venture proposal by different venture capital companies operating in a syndicate reduces therefore the potential danger of adverse selection.

The finance theory views syndication as a means of risk sharing through portfolio diversification (Manigart et al., 2002). The resource-based approach that holds for post-investment stage, however, sees the venture capital market as a pool of productive resources in which a venture capital organisation can access resources of another venture capitalist through syndication (Manigart et al., 2002; Bygrave, 1987). Access to future deal flow may be a motivation for syndicating a deal (Sharma, 2002).
Here, in the thesis an attempt has been made to explore whether venture capitalists in India prefer to syndicate with other venture capitalists or not. And if it is so, the study also evaluates the importance of various motives for syndication as considered by the Indian venture capitalists. Along with motives, the study also investigates the stages of investment preferred by these venture capitalists for syndication.

2.4 Bootstrap Financing

For a long time researchers and policy makers have argued that small businesses face severe problems in attracting external long-term capital. Entrepreneurs have always exploited variety of funding sources and used different techniques including “Bootstrap Financing” irrespective of the small or large capital requirements (Neeley, 2003). Bootstrap financing is a variety of alternative routes that owners can take to meet businesses’ financial needs without traditional institutional commitments or market obligations (Bhide, 1992; Freear, et al., 1995; Winborg and Landstrom, 2001). Yet, despite knowledge of its widespread use and its importance for small firm survival and growth, little academic work in entrepreneurship has focused on developing of an understanding of bootstrapping and how it relates to small firm development.

Bootstrapping has taken on many definitions in the literature, but there has been some recent consensus that it is a collection of methods used to minimize the amount of outside debt and equity financing needed from banks and investors (Winborg and Landstrom, 2001; Harrison and Mason, 1997). In the early 1990s, scholars began to name bootstrap finance explicitly. Over the last few years several definitions have been published, but the first pointed reference appeared in the *Harvard Business Review* where in Bhide (1992) focused on bootstrapping in the earlier stages and defined it as “launching ventures with modest personal funds.” He emphasized that use of bootstrap financing methods require a different approach than that used for the acquisition of the traditional sources of capital. Becoming operational, reaching breakeven quickly, conserving cash, and growing slowly provide strong support of a financing strategy that relies on bootstrap financing.
Freear, Sohl, and Wetzel (1995) extended the use of bootstrap financing to firms’ rapid growth stage rather than exclusively in the earliest stages of an enterprise’s life. Van Auken and Neeley (1996) found that sole proprietorships and firms requiring high capital investment relied on bootstrap financing to a greater extend than other firms. In 1997, Harrison and Mason replicated the Freear et al. (1995) found that 95% of the firms they studied had used bootstrap financial methods to varying degrees.

More recently, Winborg and Landstrom (2001) studied the bootstrapping methods used by Swedish firms. They derived six classifications of bootstrapping methods namely owner provided financing and resources, accounts receivable management methods, sharing or borrowing of resources from other firms, delaying payments, minimization of resources invested in stock through formal routines and use of government subsidies.

In this study, bootstrap financing has been evaluated from entrepreneurs’ perspective. Entrepreneurs from Gujarat have been asked to specify various bootstrapping techniques followed by them in the earlier stages of their venture development.

2.5 Business Angels

In contrast to the large volume of academic research on the role of venture capitalists, comparatively little work has been done on angel investors. Business angels are the second most important source of capital next to founders, family and friends (Roure et al., 2007). In 1999, Harrison and Mason identified three different generations research on business angels: First generation studies were focused upon studying attitudes, behaviour and characteristics of angels. These studies were replicated in other countries in the world though initiated in the US in the 1980 (Brettel, 2003; Hindle and Lee 2002; Hindle and Wenban, 1999; Landstorm, 1993; Reitan and Sorheim, 2000). The findings of these studies are well documented, and 'typical' angel profiles have been developed over the past few decades.

The Center for Venture Research at the University of New Hampshire has created one such profile of a typical angel investor. As per this profile, angels tend to invest close to their home base and individual angels rarely invest more than a few hundred thousand dollars in total (Jensen, 2002). The output of other studies also exhibited common traits like business angels are self-made males, highly active, invest locally and early on, rely
heavily on their networks to discover the deals and difficult to identify. While research of this kind is able to describe the ABC of the typical private investor, Kelley and Hay (1996) and Sorheim and Landstrom (2001) stressed that the business angel market is heterogeneous and stereotyping the average investor may be inappropriate.

In the second generation studies, researchers started to make a systematic inquiry into investment decision making process of angels with application of various theoretical concepts like agency theory, social capital, signaling etc (Feit, 1995; Prasad et al., 2000; Saetre, 2003; Sorheim, 2003; Van Osnabrugge, 2000). These decision making models are essentially based upon the prior models of how institutional venture capitalists make decisions as discussed by Tyebjee and Bruno in 1984 and other successors. Van Osnabrugge’s (2000) compared the decision making process of business angels and venture capitalists. As per this comparison, venture capitalists generate higher deal flow and are more selective at the initial screening. Venture capitalists conduct more due diligence while angels monitor post-investment more actively than venture capitalists. Venture capitalists are more concerned about exiting than angels. He also noted that business angels rather drafting comprehensive contracts between them and the entrepreneur; actively involve themselves in the post-investment to control the entrepreneur’s behaviour or the development of the venture.

Finally, third generation studies present those areas, where further research is needed in terms of certain methodological and theoretical issues with new research designs, such as case studies and longitudinal research.

As there are very few studies on business angels and virtually no such studies in Indian context yet, in this study, the potential for angel capital has also been explored. Indian venture capitalists were asked to specify whether they had invested in the proposals earlier funded by angels and these venture capitalists’ positive and negative perceptions towards angels have been empirically evaluated. Awareness of entrepreneurs belonging to Gujarat towards this source of funding has also been examined. The venture capital supported entrepreneurs were asked to specify whether they were earlier funded by the angel investors or not.
2.6 Business Incubation

Business incubators nurture young firms during their formative years when they are most vulnerable, helping them to survive and grow into viable commercial enterprises (Hamdani, 2006). Many researchers have defined incubators in many ways. As described by Albert and Gaynor (2001) Albert et al., defined an enterprise incubator as a “collective and temporary place for accommodating companies which offers space, assistance and services suited to the needs of companies being launched or recently founded”. An enterprise incubator has four principal characteristics: availability of modular and expandable space to rent for a limited period, access to shared cost services relating principally to administrative functions, access to management or technological support and privileged access to business and scientific communities and a place for interaction between companies and for moral support coordinated by management team. According to the National Business Incubation Association, business incubation is "A business support process that accelerates the successful development of startup and fledgling companies by providing entrepreneurs with an array of targeted resources and services. Critical to the definition of an incubator is the provision of management guidance, technical assistance and consulting tailored to young growing companies.” This definition describes the main purpose of incubator and the related services being provided (Sun et al., 2007).

Albert and Gaynor (2001) classified the research on incubators into descriptive, prescriptive, and evaluative research. The descriptive works define incubation, classify different types of incubators, identify key features of specific types of incubators and set out the lifecycle of an incubator. Prescriptive works are aimed at informing key stakeholders, primarily sponsors and incubator management. These studies illustrate the role of incubators in economic development, identify features of successful incubation programmes, examine other issues facing incubator management, and set out best practice guidelines and methodologies aimed at informing incubator managers on effective ways of running incubators. Evaluative works establish the metrics by which incubation programmes can be evaluated. They try to quantify the impact of incubators on firms they work with.
As incubation programme helps to attract venture capital to the incubatees, the present thesis attempts to discover the link between these two elements of the ecosystem i.e. venture capital and incubation. Venture capitalists in India were asked to indicate whether they had invested in the ventures that were incubated earlier. Entrepreneurs from Gujarat were asked to rate their awareness level with respect to the incubation programmes and their facilities and whether they availed the services of incubation centres during the early stage of venture development.

2.7 Indian Studies on Venture Capital

As mentioned before, there are very few studies in Indian context, which are specifically focused upon the process of venture capital investment. Major research is concentrated towards reporting the facts and figures regarding the evolution and trends in Indian venture capital industry. Lack of published research work in this important field has prompted the researcher to make a modest attempt to study the detailed process of venture capital investment from the venture capitalists’ perspective in India (supply side) and the role played by the venture capitalist in the growth and development of the venture from the entrepreneurs’ perspective (demand side) and the funding preferences of the young entrepreneurs in Gujarat (demand side). The extant research in various areas as discussed before in Indian context has been summarized as below.

A study by Pandey (1996) was the first one to report the evaluation criteria used by the venture capitalists in India for screening the new ventures. Questionnaire by Macmillan et al. (1985) was modified for this purpose by adding 21 new variables. As per the findings of the study, venture capital funds in India give more importance to the quality of entrepreneurs. Out of five essential criteria, four relate to entrepreneurs’ personality. Another study by Pandey (1998) presented the emergence of TDICI as a venture capital firms and also highlighted the problems it faced for developing its business.

One more study in relation to the evaluation criteria was carried out by Kumar and Kaura (2003). They studied the evaluation criteria and the performance criteria used by the Indian venture capitalists that help them in identifying successful venture teams. As per the study findings, successful venture teams put in sustained efforts on identified target markets and are highly meticulous while attending to the details. The major observation
as per this study relates to the fact that Indian venture capitalists do not seem to be biased in favour of high technology ventures as number of successful ventures are not hi-tech.

Recent study on the evaluation criteria used by the venture capitalists in India by Mishra (2005) reported the findings in confirmation with Pandey (1996) and Kumar and Kaura (2003). The results confirmed that the entrepreneurs’ personality and experience are seen as being primary indicators of the venture’s potential.

Kumar (2002) examined the locational and ownership preference preferences vis-à-vis different venture stages and found that later stage funding is based on preference for percentage ownership a venture capitalist would buy and the early stage ventures are governed by their locational preferences.

Study by Sharma (2002) is a comprehensive one and sheds lights on many stages of venture capital investment process from the venture capitalist’s perspective. The present study is modeled more or less on the theme of his study. He examined the significance and the role of venture capital industry in the light of the current business scenario in India. The study brought in light the major reasons for poor growth of venture capital industry in India and offered suggestion for its faster growth.

Subbulakshami (2004) has published an edited volume on venture capital industry in India. The book compiles various research articles in relation to role of venture capital in fostering entrepreneurship leading to overall economic growth, the origin and the regulatory framework of Indian venture capital industry as well as the development of venture capital in US, Taiwan and China.

It is worth noting here that there are few other books (Verma, 1997; Taneja, 2002; Ramesh and Gupta, 2005; Pamecha, 2002) and research articles (Nagayya, 2005; Selvakumar and Ketharaj, 2009; Vashisht, 1999) published in various journals on practices and procedures of venture capital/private equity in India. These sources of information were highly helpful in developing the literature in relation to the evolution of venture capital industry in India and analyzing the investment patterns across different sectors over a period of time. These books and articles cover various topics in relation to conceptual framework for venture capital, international scenario focused upon global venture capital industry, operations and performances of venture capital industry in
India, negotiation and structuring of deals, methods of investment monitoring, valuation of portfolio, exit strategy and the legal framework and documentation. Few other research articles and reports focus upon the growth and momentum in the venture capital industry in India (Verma, 2009; Aggarwal, 2006; Sharma, 2007; Ravi, 2007; Adilakshmi and Jampala, 2007; Chandrasekhar, 2007; Rao and Ratna; 2009). These articles discuss yearly growth patterns in terms of number of deals, amount of investment, investment by stages, industry-wise investment classification and future growth prospects for this industry.

2.8 Venture Capital Studies in Gujarat

As this research has a special focus on Gujarat, the studies in relation to venture capital in the state have also been explored. However, the researcher could not locate any published studies on venture capital industry in Gujarat. There is only one unpublished dissertation on venture capital funding and the entrepreneurs’ performance based on financial contract theory by Panwar (2005). This dissertation compares the case-study of 13 firms, funded, subsequently fully divested and supported by Gujarat Venture Finance Limited (GVFL). The results showed that venture capital supported firms achieve their objectives, with minimum risk and efforts for the maximum returns. GVFL’s contract with the entrepreneur imposes/includes all the standard clauses/provisions that help in decision making in VC appraisal, self-selection, monitoring, incentivizing and legal remedies.

2.9 Research Gap

Before proceeding towards arriving at the research gap, it is again worth noting here that the present empirical research is divided into two parts. On supply side, venture capital investment process in India has been studied while on demand side, the role played by the venture capitalist in the development of the venture has been examined with respect to the venture capital supported firms in Gujarat. Also, the potential for the venture capital investment has been explored by studying the funding preferences of entrepreneurs in Gujarat.
From the literature review of the International, Indian and regional studies as discussed above, it can be concluded that there is a good amount of research already existing in the area of venture capital funding from supply side. However, there remains much that is unknown or inadequately understood about this market place as remarked by Mason and Harrison (1999). The researcher has made an humble attempt to appreciate some of the views expressed and concepts developed in the works of various experts after a careful study of the available literature and reporting in India and abroad. To broadly categorize and analyze gaps here, it would be justified to state that the existing studies are inadequate to find out if at all there has been any change in the investment pattern or preferences of the venture capitalists in a country that has major reforms in recent times. Indian ecosystem for entrepreneurship has turned out to be more supportive and facilitating than ever before, for the venture capitalists as well as the entrepreneurs, following the social, political, technological and economic transformation in the country over a period of time.

Besides, much of the empirical research in this area has been carried out keeping US as a centre point. Venture capital research has been dominated by studies from the US. Given that institutional, legal and cultural environment affects the behaviour of the venture capital market, the need to study the empirical contributions from outside of the US has become more pronounced. In Indian context, this is a relatively a young research field, about which more remains to be learned. To add to the research gap, there is a wide vacuum on demand side i.e. entrepreneurs’ perceptions have not been investigated by the researchers. A few the Indian studies quoted in the literature review, have studied only the venture capitalists’ perspective and specifically the evaluation criteria used by them while the entrepreneurs’ perspective has been completely ignored. Further, the other stages of venture capital investment process like deal origination, deal structuring, value-added activities and exit, have not been investigated in detail by the existing studies.

Sometimes researchers are severely handicapped because they lacked good data on the investment policies and approaches of venture capitalists. This is because venture capitalists are quite secretive about the nature of their investments. Hence, research conducted in India on venture capital investment, are usually based on published data from agencies like Indian Venture capital Association (IVCA), rather surveying the respondents.
Gujarat with its thriving entrepreneurial culture is one of the ideal investment destinations in the country. However, there is a presence of only one state government supported venture capital firm i.e. Gujarat Venture Finance Limited (GVFL). Though other venture capital firms are investing in the state, much of this funding is towards late stage deals which can not be classified as pure venture capital deals. Thus, there is much scope for analyzing the existing equity gap at the state level. There is, however, much potential for the development of the knowledge based entrepreneurship in the state following the information and biotechnology revolution initiated by the government in the state. This would consequently result into higher demand for suitable funding sources for such knowledge based entrepreneurship. Thus, the prospects for the need of venture capital funding seem to be quite bright. To relate this potential, the funding preferences of the entrepreneurs from Gujarat have also been studied.

<table>
<thead>
<tr>
<th>Table 2.3 Brief Summary of Existing Research on Venture Capital</th>
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<tr>
<td><strong>International Studies</strong></td>
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<tr>
<td>Much of venture capital research at international level is dominated by studies from US and other developed nations.</td>
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<tr>
<td>Majority of these studies relate to supply side i.e. study of venture capitalists and not to the demand side i.e. entrepreneurs.</td>
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<tr>
<td>The basic theme of the research has been study of venture capital investment process with a focus on studying the evaluation criteria used by the venture capitalists and the value-adding function.</td>
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<tr>
<td><strong>Indian Studies</strong></td>
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<tr>
<td>Only few notable studies on venture capital investment process with a major focus upon the evaluation criteria</td>
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<tr>
<td>Descriptive research (books and research articles) in relation to conceptual framework for venture capital, international scenario focused upon global venture capital industry, operations and performances of venture capital industry in India, negotiation and structuring of deals, methods of investment monitoring, valuation of portfolio, exit strategy and the legal framework and documentation.</td>
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<tr>
<td>There are no studies from the entrepreneurs’ perspectives.</td>
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<td><strong>Studies Conducted in Gujarat</strong></td>
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<tr>
<td>Only one case study of 13 venture capital firms based on structure of venture capital contracts.</td>
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</table>
2.10 Conclusion

Venture capital is an age old concept. There are many studies relating to the venture capital investment process and these studies are conducted in western countries mainly US and Europe. Further, these studies focus upon the venture capitalists’ perspective. There are barely few studies describing the venture capital investment process in Indian context and with a focus on entrepreneurs’ perspective. Specifically in Gujarat, research on venture capital is not given a significant thrust. The ecosystem for entrepreneurship and venture capital has changed over a period of time and has become more conducive for its development now in India as well as in Gujarat. Therefore, this study is intended to provide empirical evidence on the venture capital investment activity and process in India, a country characterized by fast growth and an emerging techno-entrepreneurial culture. Literature review and the associated research gaps suggest that there is a potential to quantitatively test the pre and post-investment strategies and behaviour of venture capitalists in India as well as the role they play in the development of the ventures with a special focus on Gujarat. The review of literature in relation to various topics as addressed in the chapter helped in deriving the existing research gaps and further provided the necessary inputs for framing the questionnaire for the survey conducted. The research methodology adopted for the study is discussed in detail in the following chapter.