e-ISSN : 2347 - 9671, p- ISSN : 2349 - 0187

EPRA International Journal of Economic and Business Review | Vol - 4, Issue- 3, March 2016

Inno Space (SJIF) Impact Factor : 5.509(Morocco) ISI Impact Factor : 1.259 (Dubai, UAE)

ANALYSING ENTREPRENEURS PERSPECTIVE TOWARDS VENTURE CAPITAL FINANCING

Dr. Naseeb Ahmad[1]

[1]Sr. Assistant Professor, Department of Commerce and Business Studies, Jamia Millia Islamia (Central University), New Delhi, India

ABSTRACT

The paper is focussed to analyse and evaluate the perspective and financing preferences of the entrepreneurs who are seeking the venture capital finance as well as those who have obtained the venture capital funding. The study is based on primary data collected from the entrepreneurs of different industries, based in Delhi & NCR. An attempt is made to understand whether there exists a difference of opinion among diverse categories of entrepreneurs towards various aspects of venture capital financing process in Indian context.

KEY WORDS: *Venture Capital, Venture Capital Finance, Entrepreneurs' Perspective, Financing Preferences*

INTRODUCTION

Venture Capital (VC) financing plays a critical role in wealth generation by identifying, financing, and supporting new generation entrepreneurs, particularly those that seek business opportunity through innovative technologies. VC firms provide much needed finance to the new generation entrepreneurs in the form of equity, quasi equity and debt.

VC firms specialize in funding new businesses that are based on new/ untried technologies or / are high risk ventures. VC firms provide targeted funding to businesses that are promoted by technically and professionally qualified entrepreneurs. Furthermore the contribution of VC firms does not remain confined to financing as is the case with development banks and financial institutions, VCs act as business partner and mentor whereby they not only share risk and reward of the financed venture, they also provide benefits of their advice and assistance in competency development of the investee firms.

While identifying investments, VC firms follow a multiple step process which includes; deal generation, screening, evaluation, due diligence, approval and exit. This multiple step process requires a relationship between the VC firms and the prospective venture. Obviously the VC firms require great deal of information which they try to access from a variety of sources but most importantly from the entrepreneurs/ venture that seek VC funding. Clearly the process demands relationship between the financier and investee that is based on mutual trust, confidence and commonalities of interest and objectives.

The VC firms are able to create value in the firm, when they back up the investee firm through active participation on the board, acting as a sounding board to the management of the ventures and by helping with their contacts and networks. Given this demand for such an intense involvement in the management and governance of the ventures, the investee firms may feel threatened to lose control on his business or may be reluctant to share control of the business. It is thus clear that the perception and the expectation of the VC firms and the entrepreneurs seeking venture capital must converge on common grounds. Any divergence in the perception about any of the party or their processes would act as an impediment and barrier to both the parties.

OBJECTIVES AND METHODOLOGY

In this study an attempt is made to understand and evaluate the VC financing process from the perspective of the entrepreneurs who are seeking the venture capital as well as those who have obtained the venture capital (VC investee firms). The opinion and preferences of a sample of 104 entrepreneurs based in Delhi and National Capital Region (NCR) has been collected through a combination of structured questionnaire, personal interviews, blogs, e-mails, telephonic conversations, formal and informal discussions during seminars/ conferences/ mentoring sessions/ networkingevents organised by TIE (The Indus Entrepreneurs), IVCA (Indian Venture Capital Association), NASSCOM, CII (Confederation of Indian Industries) etc.

To analyse the effect of various demographic and organizational characteristics on the VC financing process and perspective and expectations of the entrepreneurs and VC investee firms, the researcher attempted cross tabulation and computed contingency coefficient (C) and Chi- square statistics. The observations and findings are discussed below.

1.1 MODE OF CONTACTING VC

There are multiple ways through which the entrepreneurs contact VCs for financing. In the present study three mode of contact has been observed. The most common mode was the entrepreneurs directly contacting the VCs (69%). In some cases the entrepreneurs were either referred by other entrepreneurs (19%), or referred by intermediaries (11%) like banks, financial institutions and other professional service providers.

Table –1.1 Mode of Approaching VC

Mode of Contact	Frequency	% Distribution
Referred by other Entrepreneur	20	19.2
Direct Contact	72	69.2
Referred by other Intermediaries	12	11.5

The mode of contacting VCs by the entrepreneurs has been examined across the different characteristic features of the respondents in order to find any significant relationship between the two. The various observations and findings are explained below;

Contact Mode & Industry:-

A significant relationship has been found between the industry type and mode of contacting VCs. It was observed that in case of industries like Information Technology Enabled Services (ITES) (79%), Banking, Financial Services & Insurance (75%) and Education & Consultancy services (73%); an overwhelming majority of entrepreneurs directly contact the VCs whereas in other industries the contact between VCs and entrepreneur is established either through an intermediary or through another entrepreneur.

Table – 1.1.1 Contact Mode & Industry

	X^2	C	df	P
Contact Mode	34.724	.500	18	.010

Contact Mode & Age:-

The age of the firm was found to affect the mode of contacting the VC. Almost all the mid age firms (84%) reported to directly contact the VC and a majority of the newly established firms (67%) also preferred to contact the VCs directly whereas only 50% of the older firms contacted the VCs directly and the rest of them contacted the VCs either through a reference by another entrepreneur or an intermediary.

Table – 1.1.2 Contact Mode & Age

	X^2	C	df	P
Contact Mode	13.565	.340	4	.009

Contact Mode & Experience Level:-

It has been observed that most of the entrepreneurs having high level of experience prefer to contact the VC directly (79%) whereas among those with lesser experience; majority of them (55%) directly contact and some (33%) were referred by another entrepreneur. Similarly those with medium experience contacted in the same fashion as that of lesser experienced.

Table – 1.1.3 Contact Mode & Experience Level

	X^2	C	df	P
Contact Mode	10.248	.299	4	.036

1.2TIME EXPECTED IN APPRAISAL

The time period expected by the entrepreneurs in the proposal evaluation process was tested in a range of 4 weeks to 20 weeks. A significant majority of the respondents (67%) reported to prefer a time frame of 8 – 12 weeks; some of the respondents (27%) preferred a shorter time span of 4 – 8 weeks whereas very few (5%) prefer a longer duration of 12 – 16 weeks or more.

Table - 1.2 Time Expected in Appraisal for VC Funding

Expected Time	Frequency	% Distribution
4-8 weeks	28	26.9
8-12 weeks	70	67.3
12-16 weeks	5	4.8
16-20 weeks	1	1

The time expected in project appraisal was examined across the different features of the respondents to find any significant relationship between the two. The findings are discussed below;

Time Expected in appraisal & Location:-

The time expected in the process of evaluation of projects for funding was not found to differ significantly across the entrepreneurs based in different locations.

Table – 1.2.1 Time Expected in Appraisal & Location

	X^2	C	df	P
Time Expected in appraisal	6.571	.244	3	.087

Time Expected in Appraisal & Experience Level:-

It has been observed that an overwhelming majority (75%) of the entrepreneurs with high level of experience reported to expect a time of 8 – 12 weeks in VC appraisal, whereas 55% of those with low experience and 56% of the entrepreneurs with medium level of experience reported to expect similar time duration in VC appraisal.

Table – 1.2.2 Time Expected in Appraisal & Experience Level

	X^2	C	df	P
Time Expected in appraisal	12.121	.323	6	.059

1.3 FINANCING PREFERENCES

The entrepreneurs were questioned for their financing preferences on various issues in the VC financing process, the responses and observations are discussed below;

i)Stage of approaching for VC

The entrepreneurs were asked about the stage of business at which they approached for venture capital. It has been observed that many of them (49%) approached at first/ early stage, followed by seed/ start-up stage (28%) and second/ later stage (15%). Only a few approached at turnaround (4%), expansion (2%) or PIPE stages (2%).

ii)Financing Instrument Preference

The real attraction for venture capital in true sense is because of its equity participation and involvement. The same fact has been observed as a majority of the firms (67%) reported to prefer equity or equity linked instrument of financing. Some of them preferred redeemable preference share (22%) whereas few (9%) liked convertible debt or non-convertible debt (2%).

iii)Exit Route Preference

There are different modes through which VCs made an exit from the investee company. Some of the common exit routes are IPO, M&A, buyback by promoters, sale to another VC, sale through secondary market (stock exchange) etc. The respondents were asked about their preference for an exit route. In the light of the flourishing stock market which is consistently strengthening, a good majority of the respondents (60%) expressed IPO as the favourite exit route. The rest of them were equally divided over Merger & Acquisitions (18%) and buyback by promoters (20%).

iv)Exit Period Preference

The exit period preference was tested in a range of 1 – 9 years. Most of the firms (68%) preferred a period of 5 – 7 years and some of them (23%) reported a shorter period of 3 – 5 years, few of them (6.7%) preferred to have VC for a very short period of 1 – 3 years.

v) Appropriate return for VC

An attempt was made to know the opinion of the entrepreneurs about the return (IRR) which will be appropriate for the VCs. Almost half of the respondents expressed that a return of 30 – 35% will be appropriate for the VC whereas some of them (27 percent) reported a higher return of 35 – 40% and few of them expressed that it should be more than 40%.

vi)Non-Disclosure Agreement (NDA) Preference

The entrepreneurs with innovative ideas are highly concerned for the confidentiality of their business plans and insist the VCs to sign the Non-Disclosure Agreement as a safeguard. In the study it has been observed that as many as 78% of the respondents prefer to have the NDA signed by the VCs compulsorily or preferably. For some (17%) of them the NDA doesn't matter and a very few (5%) stated that it is not required.

vii)Monitoring Method Preference

The involvement of the investor in the various aspects of business is a unique feature of VC funding. The entrepreneurs seek more than just money from the VC. The entrepreneurs were asked about the monitoring method they would prefer. An overwhelming majority (69%) of the respondents acknowledged that they are willing to give the VC a seat in the board to have better mentoring and assistance from the VC. The rest of them (31%) reported that the periodic reports and statements to the VCs are enough for the monitoring purpose.

Table -1.3 Financing Preferences o Entrepreneurs

Financing Issues	Frequency	% Distribution
Stage of Approaching for VC		
Seed / Start up Stage	29	27.9
First / Early stage	51	49
Second / later stage	16	15.4
Expansion	2	1.9
Turnaround	4	3.8
PIPE (Private Investment in Public Enterprises)	2	1.9
Financing Instrument Preferences		
Equity	69	66.3
Redeemable Preference Share	23	22.1
Convertible Debt	10	9.6
Non Convertible Debt	2	1.9
Exit Route Preferences		
IPO	63	60.6
Merger & Acquisitions	19	18.3
Buyback by Promoters	21	20.2
Sale to other VC	1	1
Exit Period Preferences		
1 - 3 Years	7	6.7
3 - 5 Years	24	23.1
5 - 7 Years	71	68.3
7 - 9 Years	2	1.9
Appropriate Return for VCs		
20 - 25%	3	2.9
25 - 30%	15	14.4
30 - 35%	51	49
35 - 40%	28	26.9
>40%	7	6.7
Signing of NDA Preferences		
No/ Not Required	5	4.8
Doesn't matter/ May be	18	17.3
Preferably/ Mostly	46	44.2
Compulsorily/ Always	35	33.7
Monitoring Method Preferences		
Giving a Seat in Board	72	69.2
Feedback Reports/ Statements	32	30.8
Personal Visits		

The financing preferences were examined across the different characteristic features of the respondents in order to explore any significant relationship. The various financing issues were tested across different features, the findings are explained below;

1.3.1 Financing Preferences & Location:-

The financing preferences of the firms based in different locations were found to be similar in case of all but one issue. It was observed that among the firms based in Delhi, a majority (52%) approached the VC in the first/ early stage and 38% at seed stage. In case of the firms based outside Delhi 46% approached at first/ early stage and only 17% approached the VC at seed stage.

Table – 1.3.1 Financing Preferences & Location

Financing Issues	X^2	C	df	P
Stage of Approaching for VC	13.349	.337	5	.020
Financing Instrument Preferred	3.658	.184	3	.301
Exit Route Preferred	1.918	.135	3	.590
Exit Period Preferred	2.912	.165	3	.405
Return Appropriate for VCs	3.700	.185	4	.448
NDA Preference	1.346	.113	3	.718
Monitoring Method Preferred	.181	.042	1	.671

1.3.2 Financing Preferences &Form of Organisation:-

The financing preferences of the firms have been found to be different on some issues across the different form of organisation. With respect to the financing instrument preference; majority of the private ltd. (71%) and public ltd. (62%) Companies preferred equity whereas as most of the partnership firms (67%) preferred preference shares. In response to the question of appropriate return (IRR) for VCs a majority of the public ltd firms (65 percent) reported that 30 – 35% return is appropriate. Among the private ltd firms some (39 percent) reported a return of 30- 35% and few (27 percent) reported a higher return of 35 – 40%.

Table – 1.3.2 Financing Preferences & Form of Organisation

Financing Issues	X^2	C	df	P
Stage of Approaching for VC	28.968	.467	20	.088
Financing Instrument Preferred	25.998	.447	12	.011
Exit Route Preferred	17.635	.381	12	.127
Exit Period Preferred	6.294	.239	12	.901
Return Appropriate for VCs	30.274	.475	16	.017
NDA Preference	13.157	.335	12	.358
Monitoring Method Preferred	3.382	.177	4	.496

1.3.3 Financing Preferences & Industry:-

The financing preferences of the firms have been found to differ across industry. With respect to the stage of approaching VC; majority of the firms in education & consultancy services (73%) and half of those in ITES approached in first/ early stage whereas half of the firms in BFSI and media approached in seed stage. The exit route preferences across industries were not similar. It has been observed that IPO route was preferred by all the firms in BFSI (100%) and most of the firms in media (83%), education & Consultancy services (73%) and a majority of firms in IT & ITES (61%) also preferred the IPO route as compared to other industries like manufacturing & pharma. The M&A route were preferred by only few firms in IT& ITES and pharma industry (29% each). There has been some difference of opinion among the entrepreneurs from different industries over the NDA signing preference. The respondents from the IT&ITES reported it either compulsory (52%) or preferably (31%), all the respondents from engineering & construction industry (100%) and a majority of those in BFSI sector (75%) reported it to be signed by the VCs preferably.

Table – 1.3.3 Financing Preferences & Industry

Financing Issues	X^2	C	df	P
Stage of Approaching for VC	65.446	.621	45	.025
Financing Instrument Preferred	27.820	.459	27	.420
Exit Route Preferred	46.744	.557	27	.011
Exit Period Preferred	21.245	.412	27	.775
Return Appropriate for VCs	41.538	.534	36	.242
NDA Preference	51.677	.576	27	.003
Monitoring Method Preferred	11.929	.321	9	.217

1.3.4 Financing Preferences & Age:-

The firms in different age group were found to share common viewpoint towards financing preferences. However in case of the stage of approaching VC there was a different approach; a majority of mid age firms (68%) approached in First/ Early stage whereas the new firms (49%) approached in the seed stage and the older firms (39%) approached in second/ later stage.

Table – 1.3.4 Financing Preferences & Age

Financing Issues	X^2	C	df	P
Stage of Approaching for VC	42.224	.537	10	.000
Financing Instrument Preferred	5.492	.224	6	.482
Exit Route Preferred	18.541	.389	6	.005
Exit Period Preferred	4.597	.206	6	.596
Return Appropriate for VCs	9.502	.289	8	.302
NDA Preference	9.539	.290	6	.145
Monitoring Method Preferred	.749	.085	2	.688

1.4. LEVEL OF VC INVOLVEMENT EXPECTED

The venture capital is not just like any other means of finance. The active involvement of the VC in the companies they finance is one unique feature of it, which is the biggest attraction for a first generation entrepreneur. The entrepreneurs were asked about the level of involvement they expect from the VC. The involvement level was ranked in a scale of 1 to 4 (where 1 = Never/ No involvement and 4 = Always/ High involvement). The feedback in this regard has been obtained in two categories i.e. overall involvement and involvement in specific managerial issues. The majority of the respondents (63%) reported to prefer a medium level of involvement as far as overall involvement is concerned. In case of involvement in specific area, networking support from the VC is the most sought after area. A significant number of respondents expect either a high level of involvement (48%) or medium involvement (37%) in networking support. The other areas where entrepreneurs expect to have the involvement/ assistance of VC are financial management and marketing issues.

Table –1.4 : Level of VC Involvement Expected by Entrepreneurs

Area of Involvement/ Assistance	Always (High)	Mostly (Medium)	Rarely (Low)	Never (No)	Mean Score	Rank
Overall	25 (24%)	65 (62.5%)	14 (13.5%)		219	-
Marketing issues	11 (10.6%)	55 (52.9%)	31 (29.8%)	7 (6.7%)	174	III
Financial Management & Planning	28 (26.9%)	59 (56.7%)	12 (11.5%)	5 (4.8%)	214	II
Manpower Planning & HR issues		19 (18.3%)	65 (62.5%)	20 (19.2%)	103	V
Networking Support	50 (48.1%)	39 (37.5%)	10 (9.6%)	5 (4.8%)	238	I
Technological Assistance	11 (10.6%)	33 (31.7%)	52 (50%)	8 (7.7%)	151	IV

The level of VC involvement in various managerial issues expected by the entrepreneurs was examined across the different characteristics of the responding firms to find any significant relationship. The various managerial issues were tested across different features; the findings are discussed below;

1.4.1 VC involvement & Form of Organisation:-

The level of VC involvement and assistance reported by the respondents of the firms having different form of organisation were also not found to differ significantly.

Table – 1.4.1 VC involvement & Form of Organisation

Area of involvement / Assistance	X^2	C	df	P
Overall involvement	14.437	.349	8	.071
Marketing issues / Assistance	12.895	.332	12	.377
Financial Management Issues	12.515	.328	12	.405
Manpower & HR Issues	10.533	.303	8	.230
Networking Support	13.046	.334	12	.366
Technological Assistance	8.152	.270	12	.773

1.4.2 VC involvement & Industry:-

The level of VC involvement expected was found to differ across industries. With respect to overall involvement, the firms in the BFSI (50%) and media (50%) reported a high level of involvement. Most of the firms in manufacturing (86%), pharma (85%), retail (80%) and ITES (63%) reported a medium level of VC involvement and a majority of the firms in engineering & construction sector (75%) preferred a low level of VC involvement. The assistance in terms of networking support was found to be high in case of manufacturing (71%) and media (67%), whereas the sector like pharma (71%) and engineering & construction (50%) reported the support to be medium

Table – 1.4.2 VC involvement & Industry

Area of involvement / Assistance	X^2	C	df	P
Overall involvement	30.049	.473	18	.037
Marketing issues / Assistance	31.781	.484	27	.240
Financial Management Issues	36.102	.508	27	.113
Manpower & HR Issues	22.111	.419	18	.227
Networking Support	43.959	.545	27	.021
Technological Assistance	25.329	.443	27	.556

1.4.3 VC involvement & Age:-

With respect to age of the firm and overall VC involvement, most of the mid age firms (77%) reported a medium level of VC involvement whereas a majority of the new firms expected a medium (54%) to high level (38%) of VC involvement and most of the older firms responded a medium (61%) to low level (33%) of VC involvement. The VC involvement reported in the financial management issues also varied compared to the age of the firm. The new firms preferred a medium (54%) to high involvement (34%), a majority of the older firms preferred a medium (55%) to low involvement (33%) and a majority of mid age firms preferred a medium (61%) to high level (26%) of VC involvement in financial management issues.

Table – 1.4.3: VC involvement & Age

Area of involvement / Assistance	X^2	C	df	P
Overall involvement	18.313	.387	4	.001
Marketing issues / Assistance	10.760	.306	6	.096
Financial Management Issues	16.543	.370	6	.011
Manpower & HR Issues	10.330	.301	4	.035
Networking Support	7.054	.252	6	.316
Technological Assistance	6.900	.249	6	.330

1.4.4.VC involvement & Experience Level:-

The experience level of entrepreneurs and the expected VC involvement/ assistance has been found to be similar except in case of manpower & HR issues. Most of the entrepreneurs with low experience (89%) preferred low level of VC involvement in issues concerned with manpower planning and recruitment, a majority of the entrepreneurs with high level of experience (62%) also preferred a low level of VC involvement whereas some of those with medium level of experience (38%) preferred medium level of VC involvement.

Table – 1.4.4: VC involvement & Experience Level

Area of involvement / Assistance	X^2	C	df	P
Overall involvement	6.125	.236	4	.190
Marketing issues / Assistance	10.355	.301	6	.110
Financial Management Issues	11.594	.317	6	.072
Manpower & HR Issues	17.967	.384	4	.001
Networking Support	1.056	.100	6	.983
Technological Assistance	8.546	.276	6	.201

CONCLUSION

The discussion in the paper has been based on the opinion and perception of the entrepreneurs/ VC investee firms with respect to the financing process and preferences and this has led to some very interesting observations and findings which may be considered of significance in the overall venture capital financing process.

As regards mode of contacting, the entrepreneurs also prefer the direct contact method and thus the perception of the VC firms and entrepreneurs had no divergence, so was the case with respect to time taken in project appraisal. It was found in the earlier studies that VC firms take 8 – 12 weeks time in arriving at a decision to invest in a proposal, nearly 70% of the entrepreneurs are reconciled to this idea and they feel happy if VC firms take 8 – 12 weeks to arrive at a decision. The analyses also shows that majority of entrepreneurs feel like approaching VC firms at the start up stage and are willing to share equity with VC firms. It was also found that an overwhelming majority of entrepreneur would like 5 – 7 years time before exit and would prefer IPO as the exit route. There is also convergence of perception about the appropriate return that the VCs should get out of their investment. A clear conflict has been observed in case of signing non-disclosure agreement, VCs are reluctant to sign it whereas an overwhelming majority of entrepreneurs would like to get it signed in order to protect their sensitive information/ ideas. Significantly, however only about 70% of the entrepreneurs felt that given a seat in the board to VCs is acceptable, while the rest felt like monitoring through feedback reports and statements as a desirable monitoring method.

As regards involvement of VCs, the entrepreneurs demand that they should get networking support followed by financial management planning. While marketing issues and technological assistance was also preferred by them but scored third and fourth in their order of preference.

REFERENCES

1. *AVCJ, Asian Venture Capital Journal 2014.*
2. *Bayar Onur, Thomas J. Chemmanur, "IPO's versus Acquisition & the Valuation Premium Puzzle: A Theory of Exit Choice by Entreneurs & Venture Capitalists", 2010.*
3. *Cope J., Cave F. Eccles S.(2004), Attitudes of Venture Capital Investors towards Entrepreneurs with Previous Business Failure. Venture Capital, April- September 2004, Vol. 6, No. 2/3, pp. 147-172.*
4. *Damodaran Aswath, "Valuing Young, Start-Up & Growth Companies: Estimation Issues & Valuation Challenges" New York University-Stern School of Business, 2009.*
5. *Dossani, R. and Desai (2006) Accessing Early Stage risk Capital in India, Standard University.*
6. *G.Tyge Payne, Justin L. Davis, Curt B. Moore, R.Greg Bell, "The Deal Structuring Stage of Venture Capitalist Decision Making Process: Exploring Confidence & Control.", 2010.*
7. *Janson, C., Frank, C., Sue, E. (2004), Attitudes of Venture Capital Investors Towards Entrepreneurs with Previous Business Failure.*
8. *Marjan Petreski, "The Role of Venture Capital in Financing Small Businesses",Journal of Entrepreneurship & Finance (2006).*
9. *Xuan Tian, "The Causes & Consequences of Venture Capital Stage Financing", Journal of Financial Economics, 2010.*

✡✡✡✡✡✡✡✡