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Success and Failure of Venture Capitalists' Portfolio Management-A Study

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ABSTRACT:
Venture capital investment are a substantial tool of innovation and economic growth, but highly risky from an individual investor's point of view. Venture Capitalists are investors make high-risk equity investments in new portfolio companies and support continuously for the success of the portfolio companies. In this article the authors studied nine factors that contribute for success and failure of venture capitalists portfolio. They are management, market, product, manpower, technology, government policy, team support, contribution of promoters and deal fund. The authors conducted a survey of venture capitalist operating in South India to assess the relative importance of these factors in determining the outcome of portfolios.
The result suggest that three factors high influence for success of venture capitalist portfolio companies are product, market and management efficiency and for the failure of portfolio companies factors are poor product features, market sluggishness and government policies.
KEYWORDS: *Venture Capital, Portfolio Companies, Venture Capitalists', Success of Portfolio, Failure of Portfolio, Information Technology.*
GEL Classification: *G24, G11*

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I. INTRODUCTION:

Venture Capital (VC) has emerged as the dominant source of finance for start up and early stage entrepreneur. The VC investment cycle consists of four phases, namely, fund raising, selection and investment, monitoring and exit. During the fund raising phase, VC firms (commonly known as general partners or GPs) raise capital from various investors (commonly known as limited partners or LPs) such as financial institutions, corporations, university endowments, family offices, and wealthy individuals. During the selection and investment phase, the VC firms evaluate various investment opportunities to deploy the funds raised. They use various screening and selection criteria to identify suitable investment opportunities. The monitoring phase is the time interval between date of investment and exit of the VC investor. During this phase, the VC works closely with the investee firm **(AT Rajan, 2010)**[1]. Apart from providing capital, VC, use their specific industrial knowledge, expertise, and contacts to assist their portfolio firms in various areas such as strategic and operational planning, personnel and supplier selection, marketing, financing, and even assume managerial roles where necessary **(MacMillan, Kulow and Kholian, 1989)**[2]. During the exit phase, the VC firms realize returns on their investments in the portfolio company, and return the capital to the investors in the fund. Since VC funds are generally structured al close ended funds, the VCs have to liquidate their investments after a certain period and cannot hold on to them forever. The common routes of exit in India are Initial Public Offering (IPO) and Trade Sale or Acquisition.

Baum and Silverman (2004)[3] study indicate that alliance and intellectual property have a similar effect on attracting VC investment and subsequent firm performance. On the other hand, human capital or top management characteristics of the firm that was associated with VC investments had little effect on subsequent

[1] Rajan, A. T. (2010). Venture capital and efficiency of portfolio companies. *IIMB Management Review*, *22*(4), 186-197.
[2] MacMillan, I. C., Kulow, D. M., & Khoylian, R. (1989). Venture capitalists' involvement in their investments: Extent and performance. *Journal of business venturing*, *4*(1), 27-47.
[3] Baum, J. A., & Silverman, B. S. (2004). Picking winners or building them? Alliance, intellectual, and human capital as selection criteria in venture financing and performance of biotechnology startups. *Journal of business venturing*, *19*(3), 411-436.

firm performance. This suggests a combination of both the selection and value addition roles in influencing portfolio company performance. Venture Capitalists are able to select companies that have strong technology and relationships, but those that are at an increased risk of short term failure. They then provide management inputs that enhance the long term survival of the firm and contribute to superior performance and success.

II. REVIEW OF LITERATURE:

Roure and Maidique (1986)[4] the study predict both successful and unsuccessful ventures targeted high gross margin, had founders with over five years of relevant experience, had experienced venture capitalists, on their boards, and were characterized by a wide range of founder equity shares.

Roure and Keeley (1990)[5] this study considers only high potential, technology based new ventures-the companies on which venture capitalists concentrate. They propose 11 measured qualities describing management, the firm's strategy and its environment based on three level analyses.

Dimo Dimov and Dirk De Clercq (2006)[6] in this study examine the relationship between venture capital firms (VCFs) investment strategies and their portfolio failure rates. They indicate two aspects of a venture capital firm investment strategy: (1) the extent to which the VCF develops specialized expertise and (2) the extent to which the VCF undertakes investments in cooperation with other investors through syndication. They found that a VCFs specialized development stage expertise had a negative effect on the proportion of defaults in the VCFs portfolio. They also set up that the level of syndication positively rather than negatively affected the proportion of defaults.

Scope of the Study:

The present study is including both registered and unregistered domestic and foreign venture capital firms located and operating in South India. The study excludes Angel investors. The study is restricted to South Indian states such as Karnataka, Andhra Pradesh, Tamil Nadu, and Kerala. Currently there are 22 portfolio companies during which investments are made by these risk capital funds. In support of the study only top first portfolio is considered that is IT &ITES.

The study is also based on the data of IVCA for a period of 21 years from 1998 to 2019.

Both quantitative and qualitative data were collected through fieldwork in South India. A statistical analysis of data collected in a structured questionnaire was the primary method for testing the success and failure factors.

Objectives of the Study:

Research Question	Objective
What factor contributes for success and failure of portfolio companies?	To make out the success and failures rates of portfolio companies

III. METHODOLOGY

This is a descriptive study of analytical nature requiring rigid field survey. Survey method has been used to collect both primary and secondary data. Therefore, both primary and secondary data has been collected through an extensive survey.

IV. RESULTS AND ANALYSIS

Factors contributing for the Success of Portfolio Companies:

Table 1.1: Factors contributing for the Success of Portfolio Companies

Sl. No.	Success Factors	Response				
		Max. Score	Mean	SD	Mean %	SD %
1	Management efficiency	5	4.08	1.52	81.6	30.4
2	Product features	5	4.49	2.13	89.8	42.6
3	Market growth	5	4.44	1.95	88.8	39.0
4	Government Policies	5	4.03	1.84	80.6	36.8
5	Core promoter is also the CEO of company	5	1.98	0.98	39.6	19.6
6	CEO is a professional; holds equity in a company	5	1.62	0.81	32.4	16.2

[4] Roure, J. B., & Maidique, M. A. (1986). Linking prefunding factors and high-technology venture success: An exploratory study. *Journal of Business Venturing*, *1*(3), 295-306.

[5] Roure, J. B., & Keeley, R. H. (1990). Predictors of success in new technology based ventures. *Journal of business venturing*, *5*(4), 201-220.

[6] Dimo Dimov and Dirk De Clercq (2006) "Venture Capital Investment Strategy and Portfolio Failure Rate: A Longitudinal Study" "Entrepreneurship Theory and Practice" Pp.207 to 223.

7	Cutting edge Technology	5	1.58	1.23	31.6	24.6
8	All senior functionaries hold equity/Deal	5	3.88	1.38	77.6	27.6
9	Ability to attract quality manpower	5	2.48	1.04	49.6	20.8
Combined		**45**	**28.58**	**12.88**	**63.51**	**28.62**

Source: Survey Data

Analysis:

From the table 1.1, it shows the major three factors responsible for success of portfolio companies are product features with the mean score of 4.49, market growth with the mean score of 4.44, and management efficiency with the mean score of 4.08. In general, venture capitalist backed ventures are more likely to be successful than non-VC backed ventures **(Gupta and Sapienza 1992[7]; Sandberg 1988[8])**. **Vinay and Mohinder (2003)[9]** their study brings out four important variables which are highly unique to successful venture in India. They are: 1) ability to evaluate and react to risk, 2) attention to details, 3) market share, and 4) profits. On the other side, the failure rates also high. Many of the VC backed ventures actually fail to earn a positive return on their investment. Then what makes the difference between successful and failure ventures? To a large extent, the ability of the VCs plays an important role in this regard. Their intelligence will be passed onto the portfolio companies along with the input of money which can greatly influence the performance of the investees.

Factors contributing for the Failure of Portfolio Companies:

Table 1.2: Factors contributing for the Failure of Portfolio Companies

Sl. No.	Failure Factors	Response				
		Max. Score	Mean	SD	Mean %	SD %
1	Management inefficiency	5	3.75	1.12	75.0	22.4
2	Poor Product	5	4.52	1.14	90.4	22.8
3	Market Sluggishness	5	3.98	1.51	79.6	30.2
4	Government Policies	5	3.83	1.23	76.6	24.6
5	Inappropriate technology	5	4.01	0.85	80.2	17.0
6	Inability to attract quality manpower	5	4.11	0.80	82.2	16.0
7	Lack of funds	5	4.08	0.87	81.6	17.4
8	Poor technology	5	3.95	0.56	79.0	11.2
9	Labour relations	5	2.58	0.65	51.6	13.0
Combined		**45**	**34.81**	**8.43**	**77.35**	**18.73**

Source: Survey Data

Analysis:

From the table 1.2, it shows the major three factors responsible for failure of portfolio companies are poor product features with the mean score of 4.52, market sluggishness with the mean score of 3.98, and government policies with the mean score of 3.83. Other side, the failure rates also high. Several of the VC backed ventures actually fail to earn a positive return on their investment. Then what makes the difference between successful and failure ventures? To a large degree, the ability of the VCs plays an important role in this regard. Their cleverness will be passed onto the portfolio companies along with the input of money which can greatly influence the performance of the investees.

Internal Portfolios Support for the Success:

The table 1.3 gives the information about internal portfolios support teams and operating partners are responsible for value creation, in most firms, two or three full time employees are involved. The panel members who contribute for the success of the firm are inside portfolio support team, inner operating partners, specialist adviser, Ex-industry specialists, and outside management consultants.

Table 1.3: Internal Portfolios Support for the Success and to create value

Sl. No.	Items
1	Internal portfolio support teams
2	Internal operating partners

[7] Gupta, A. K., & Sapienza, H. J. (1992). Determinants of venture capital firms' preferences regarding the industry diversity and geographic scope of their investments. *Journal of Business Venturing*, *7*(5), 347-362.
[8] Sandberg, W. R., & Hofer, C. W. (1988). Improving new venture performance: The role of strategy, industry structure, and the entrepreneur. *Journal of Business venturing*, *2*(1), 5-28.
[9]Kumar, A. V., & Kaura, M. N. (2003). Venture capitalists' screening criteria.*Vikalpa*, *28*(2), 49-60.

3	Expert adviser
4	Ex-industry specialists
5	External management consultants

Source: Bain Private Equity Survey Report 2016

Difference in Successful and Unsuccessful Ventures (Wilcoxon Signed Rank Test)

Table 1.4: Difference in Successful and Unsuccessful Ventures (Wilcoxon Signed Rank Test)

Variables		N	Mean Rank	Sum	Table Value	Test Value
Ability to evaluate and react to risk well	N	34	17.50	595.00	.0005	.000
	P	0	.00	.00		
	T	5				
	ToT	39				
Attention to details	N	34	17.50	595.00	.0005	.000
	P	0	.00	.00		
	T	5				
	ToT	39				
Market Share	N	33	17.00	561.00	.0005	.000
	P	0	.00	.00		
	T	6				
	ToT	39				
Profits	N	36	18.50	666.00	.0005	.000
	P	0	.00	.00		
	T	3				
	ToT	39				

N=Negative Rank, P=Positive Rank, T=Ties, ToT=Total

Source: Survey Data

Analysis:

Wilcoxon Signed Rank test used to test the difference in variable pairs of both successful and unsuccessful ventures as rated by venture capitalists. From the outcome shows that the four variables that are highly distinctive to successful venture teams are: (1) ability to evaluate and react to risk, (2) attention to details, (3) market share, and (4) profits. Winning teams achieve the expected market share by focusing their efforts on established markets and penetrate these markets to achieve profits, while unsuccessful teams often fail on these counts.

V. FINDINGS AND CONCLUSION:

- It shows the major three factors responsible for success of portfolio companies are product features with the mean score of 4.49, market growth with the mean score of 4.44, and management efficiency with the mean score of 4.08. In general, venture capitalist backed ventures are more likely to be successful than non-VC backed ventures
- It observed that the major three factors responsible for failure of portfolio companies are poor product features with the mean score of 4.52, market sluggishness with the mean score of 3.98, and government policies with the mean score of 3.83.
- The information about internal portfolios supports teams and operating partners are responsible for value creation, in most firms, two or three full time employees are involved. The team members who add for the success of the firm are inner portfolio support team, inside operating partners, specialist adviser, Ex-industry specialists, and external management consultants.

Previous studies show that VC funded companies show superior performance and success to non VC funded companies. Venture Capital firm not only provide fund and also create value addition to the portfolio companies is an important features of VC investment and one which distinguishes it from other sources of funds. Previous research (such as, Gorman and Sahlman, 1989, MacMillan et al., 1989, Rosenstein, 1988, Rosenstein et al., 1989, Sapienza and Timmons, 1989, Hellmann and Puri, 2002) gives an understanding of the involvement of VCs in the portfolio companies after investment and contribute for the success of portfolio companies. Therefore, VC funded companies show more success rate.

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