VENTURE CAPITAL IN INDIA

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Abstract
Venture capital is a new way of funding of business and has emerged as a boon to cash-strapped entrepreneurs with robust business ideas. Venture capital is the capital invested in the equity and debt securities of young unproven companies by budding entrepreneurs who do not have the capital to run their business. Professional money managers who have special knowledge of the industry in which the start-up is founded, provide money to run the business in return for a share in the management and also in the profits of such start-up. The investment in such companies is highly risky but if the venture is successful their returns too are very high. There is an urgent need for Venture capital in India, yet the venture capital market is growing very slowly and is not sufficient to meet the gap in the industry. This paper focuses briefly on venture capital mode of raising finance and the venture capital environment in India.

Keywords:
Venture capital, investment, returns, evaluation, Start-up India, growth, industry, entrepreneurs, new business, return on investment, risk, finance, institutions, profitability, seed money, exit route, IPO, regulations,

Meaning
The term "Venture capital" has no strict definition; it refers to money provided to those newly started start-ups or smaller business as capital which are perceived to have long-term growth potential. "Venture" means an activity that involves risk and "capital "is money needed to start a business and hence the name venture capital. The person providing such capital is called as "Venture capitalist" and the company making such investment is called as "Venture capital Company".

Need
Globalism has actively promoted trade and commerce sans frontiers. This has given rise to many industries and the competition is fierce. With different investment opportunities available to entrepreneurs, more people are coming forward to start their own business. Venture capital is a great encouragement for the new entrepreneurs who are in need of funds for their brilliant business ideas. In return for the money by venture capitalists, the entrepreneurs offer them a share in the management of the start-up and also a percentage in the profits they would be making in the future. The terms of venture capital agreement differs from business to business and deals.

Based on what stage of the business the venture capital is sought, it can be classified as:

Seed money:
This capital is provided at the nascent stage of a business to support an idea or to undertake research and development in a particular area which looks promising to the venture capital company. The money is locked up for about 5 to 9 years, only after which the results can be seen.
Start-up stage
This money is provided for starting the basic operations of the business or to develop prototypes or to take care of the testing stage. Money is typically locked up for 4 to 9 years.

First stage
This funding is done to start the commercial production and marketing. At this stage it is clear that the business has completed the testing and design stage successfully and is confident of producing the desired product/ offering the desired service. The money is locked up for 3 to 7 years.

Second stage
This is the working capital needed for early stage companies that have commenced sales but are yet to make profit. Here the business seeks to continue the sales in the hope of making profit soon. The money is locked up for 3 to 7 years.

Third stage
This is expansion money for a newly profitable company. At this stage the company has successfully started selling and also started to make profits. Now it seeks to further expand its business to augment its profitability. Money is locked up for 1 to 5 years.

Fourth stage
Thesis called "bridge financing", it is intended to finance the "going to public for funds" process. At this stage, the company has a fairly good track record of profits and has established itself in the market. Now it needs huge funds to increase its scale of production or diversify into newer segments; it decides to approach the public with an IPO.

Among the various stages as listed above, the seed stage till the second stage is highly risky investment as there isevery chance that the business idea fails or that the company fails to get customers in the market or the products do not function as expected. There are many cases where the start-ups fail in the initial stages and the money provided by the venture capitalists goes down the drain.Hence the key factor in venture capital investment is the heavy risk associated with it. Of course if the product /service become a huge hit the return of investment is manifold times for the Venture capitalists.

<u>Salient features of Venture capital:</u>

(1) Long time frame
(2) Lengthy complex process of appraisal and selection of start-up
(3) Money locked up means no liquidity
(4) High risk factor
(5) Equity participation by venture capitalists
(6) Representation in management
(7) Easier funds for the entrepreneur
(8) Promotion of new business ideas, products and services
(9) Boon to industrial growth
10) Finance to new or smaller companies

Various methods of Venture capital finance:

(i) Equity
(ii) Quasi –Equity
(iii) Conditional loan
(iv) Income note
(v) Participating debentures

Process off Venture financing:

a) Deal origination
b) Screening
c) Evaluation of project
d) Deal structuring
e) Post investment activity
f) Exit route

Methods of exit:

a) Initial Public Offer {IPO}
b) Trade Sale
c) Buy back by promoter
d) Acquisition by another company
e) Shutting down of the business and liquidation

Venture capital firms can be categorized as incubators, angel investors, venture capitalists and private equity players depending on their size of investment and management participation
Some of the merits and demerits for venture capital are as follows:

1) As compared to the traditional route of loan financing, Venture capital does not have any stipulated payback period. This makes it a flexible and convenient type of funding for new businesses.
2) Venture capital is a big boon to struggling entrepreneurs with great ideas but short of funds to execute their ideas. Venture capitalists not only provide money but also provide advice or gather advice from industry experts to help the entrepreneur.
3) Venture capitalists are typically well connected in the industry and the start-ups can make use of their network for improving their business prospects.
4) The strict regulation of venture capital investment makes it almost impossible for unscrupulous person to pose as serious entrepreneurs.
5) If the new business becomes successful it means faster growth and higher returns which benefit also the venture capitalists that usually have a stake in the ownership or profits of the business.

1) The funding needed from venture capital is a complex and lengthy process. It is not easy to convince the Venture capital companies about the long term potential of the entrepreneurs business or business idea.
2) The Venture capitalists may impose additional condition for funding which may hamper the independence of the entrepreneur.
3) The Venture capitalists may demand higher stakes in the business which could lead to loss of control of ownership by the original promoter.
4) Start-ups take lot of time to establish break-even and make profits. Till such time the money of the Venture capitalists is locked up with the start-up firm.
5) In the highly competitive business world, there have been instances of the venture capitalists replicating the ideas of the start-up in their own companies and gaining an unfair edge over the bootstrapped entrepreneur.

The Indian Scenario:
The concept of Venture capital was formally introduced in India by IDBI in March 1987 and later in the same year the ICICI followed suit.

The year 1988 remains significant for the growth of venture capital financing in India. The government's awakening to the potential of venture capital occurred in conjunction with the World Bank's interest in encouraging economic liberalization in India. The government of India announced guidelines for the establishment and functioning of venture capital activities on November 25, 1988.

In 1988, the first organization to identify itself as a Venture capital operation was Technology Development & Information Company of India Ltd. (TDICI) which was established in Bangalore as a subsidiary of the Industrial Credit & Investment Corporation of India, Ltd. (ICICI).

Venture financing in India is done by:

(i) Central Government promoted development institutions
(ii) State Government promoted development institutions
(iii) Institutions promoted by public sector banks
(iv) Institutions promoted by private sector banks
(v) Institutions promoted by Overseas Venture capital Funds

The Securities Exchange Board of India has issued several regulations to be followed by Venture capital companies. The strict regulations ensure that there is transparency of money flow, (including overseas funds) accountability by the parties and that the activity is carried on in a fair manner and not against public interest.

As per SEBI "a Venture Capital fund" means a fund established in the form of a trust or a company including a body corporate registered under the SEBI regulations which has a dedicated pool of capital raised in the manner specified and invests or proposes to invest in venture capital undertaking in accordance with the regulations.

The Venture capital market in India is expanding albeit slowly. From 2014 to 2016, more than a thousand start-ups had to shut down due to paucity of funding. This shows the growing need for venture financing in the country. Though the numbers of deals have not increased in the last decade, the deal size is growing. Between 2007 and 2017 the deal size grew to five times and touched close to USD 4 billion by 2017, as per a recent Bain report. It is interesting to note that India has the world's third largest start-up eco system but the Venture capital funding is still not proportionately rising.

There are only about 300 venture capitalist firms in 2018 in India which is definitely smaller compared to the number of new firms cropping up every year. High funding is seen by global firms rather than domesticfirm's who are still shy to take the market risk. Google made its first direct investment in India in Bangalore based personal concierge app Dunzo, in 2017 and the second one in e-commerce start-up Fiend. Other big players include Sequoia, Accel, Matrix and Kalahari capital.

It is notable that 30% per cent of new businesses fail in the first two years, 50% in the first five years and 66% during the first ten years for business. With such a high risk Venture capitalists show hesitation to fund companies, however if the start-up takes off well the return on investment is phenomenal. Tiger Global one of the investment funds which funded Flipchart initially made tenfold return on its investments by way of higher valuations.

In 2017, the exits were worth over US$4 billion. In 2018, Private equity and Venture capital investments stood at US$ 20.5 billion across 786 transactions on account of tech-enabled startups, e-commerce and technology enabled services according to a Grant Thornton report.The exit value skyrocketed to nearly US$20 billion on the back of Flipkart's US$16.8

billion sale to Wal-Mart, comprising 80% of the total exit value in the nine months ending September 2018.

Venture capital companies can revive sick units and assist ancillary units in their development. Tourism , public health care, insurance , hospitality, transportation are some of the service sectors that look forward to venture financing besides budding entrepreneurs who are fresh graduates out of colleges, engineering universities and management institutes .

Mumbai, Bangalore, Hyderabad, Pune, Chennai, Delhi are some of the popular destinations for venture capital companies. The sectors that receive Venture capital financing in India are IT, Telecom, ITES, Media, Pharmaceuticals, Bio-tech, and Finance & Banking

Conclusion

Unlike the US, venture capital is still in its nascent stage in India. Lack of awareness, fear of risk, hesitation to approach the market, lack of easy exit routes are some of the factors that impede the growth of the venture capital business in India. The recent developments in the economic regime of the country along with the encouragement given by government forthe commercialization of new technologies, the backward integration of existing technologies, the domestic production of foreign technologies and initiatives like Start-up India , has given a big boost to the venture financing environment in India. In the future Venture capitalism is expected to grow by leaps and bounds in India as the government initiatives to support entrepreneurship and the willingness and interest of new entrepreneurs look promising.

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