

Venture Capital Financing in India- Need of An Hour

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ABSTRACT

The combination of entrepreneurship education in schools and colleges, the hassle-free flow of venture capital and evolution of good market will give momentum for the National Growth. Venture capital finance in India was known since nineties. It is now has successfully emerged for all the business firms that take up risky projects and have high growth prospects. The private organization which does not want to take finance from the society may have their view on venture capital. It has potential to become an important source for financing of small-scale enterprises (SSEs). Venture capital finance is often thought of as 'the early stage financing of new and young enterprises seeking to grow rapidly. According to Pratt: There is a popular misconception that high-technology is the principal driving factor behind the investment decision of a US venture capitalist. Only a small minority of venture capital investments are in new concepts of technology where potential technical problems add a significant amount of risk to the new business development.

INTRODUCTION

Venture Capital refers to the finance provided by Venture Capitalists, who invest in relatively new, high growth companies or startups that have a potential to grow and develop into highly profitable ventures. It has high-risk and high-return characteristics. Therefore, it acts as an important source of finance for entrepreneurs with new ideas.

Venture Capital is the most suitable form of funding for companies and for businesses having large up-front capital requirements which have no other cheap alternatives.

What is Venture Capital?

It is a private or institutional investment made to early start-up companies. Venture Capital is money invested in businesses that are small; or exist only as an initial stage but have huge potential to grow. The people who invest this money are known as venture capitalists.

It is an investment made when a venture capitalist buys shares of a startup company and become a financial partner in the business.

Venture Capital is also stated as a huge capital risk or patient risk capital investment, as it involves the risk of losing the money if the venture doesn't succeed.

It is the basically the money invested by an outside investor to finance a new, growing or troubled business. The money invested, by capitalists, is in exchange for an equity stake in the business rather than given as a loan.

Importance of Venture Capital

Venture Capital institutions lets entrepreneurs convert their knowledge into viable projects with the assistance of such Venture Capital institutions.

- It helps new products with modern technology become commercially feasible.
- It promotes export oriented units to earn more foreign exchange.
- It not only provide the financial institution but also assist in management, technical and others.
- It strengthens the capital market which not only improves the borrowing concern but also creates a situation whereby they can raise their own capital through capital market.
- It promotes modern technology through the process where financial institutions encourage business ventures with new technology.
- Many sick companies get a turn around after getting proper nursing from such Venture Capital institutions.

Features of Venture Capital

High-risk investment: It is highly risky and the chances of failure are much higher as it provides long-term startup capital to high risk-high reward ventures.

High Tech projects: Generally, venture capital investments are made in high tech projects or areas using new technologies as they have higher returns.

Participation in Management: Venture Capitalists act complementary to the entrepreneurs, for better or worse, in making decisions for the direction of the company.

Length of Investment: The investors eventually seek to exit in three to seven years. The process takes several years for having significant returns and also need the talent of venture capitalist and entrepreneurs to reach completion.

Illiquid Investment: It is an investment that is not subject to repayment on demand or a repayment schedule.

Venture Capital in India

Evolution of Venture Capital

In 1983, the first analysis was reported on risk capital in India. It indicated that new companies often face barriers while entering into the capital market and also for raising equity finance which weakens their future expansion and growth. It also indicated that on the whole, there is a need to assess the equity cult by ensuring competitive return on equity investment. This all came out as institutional inadequacies and resulted in the evolution of Venture Capital.

In India, IFCO was the first institution to initiate the idea of Venture Capital when it established the Risk Capital Foundation in 1975. It provided the seed capital to all small and risky projects. However, the concept of Venture Capital got its recognition for the first time in the budget for the year 1986-87.

Objectives of Venture Capital in India

It allows for the working together of capitalists and startups/businesses closely and for the promoting of entrepreneurs to focus on making more and more ideas.

- It creates an environment suitable for knowledge and technology-based enterprises.
- It helps to boost scientific, technology and knowledge-based ideas into a powerful engine of economic growth and wealth creation in a suitable manner.
- It aims to play a catalytic role to India on the world map as a success story.
- Process Of Venture Capital Financing
- The Venture Capital Funding process gets completed in six different stages:

Seed Stage

In this stage, a small amount of capital is provided to an entrepreneur to market a better idea having future prospects. The investor investigates into the business plan before making any investment and, if he is not satisfied with the idea or he does not see any potential in the idea/product, then the investor may not consider financing the idea. But in case if the part of the idea is worth, then the investor may spend some time and money further on the idea. At this stage, the risk factor is very high because there are many uncertain factors.

Startup Stage

If the idea/product is fit for further investigation, then the process moves on to the second stage, also known as the Start-up stage. At this stage Venture Capital has to submit a business plan which must include the following:-

- Executive summary of the business plan,

- Review of current competitive scenario,
- In-detailed financial projections,
- Details of the management of the company,
- Description of the size and potential of the market.

All the above analysis needs to be submitted, in order to decide, whether or not, Venture Capital to take the project or not. This type of financing is provided to complete product development and commence initial market strategies.

Second Stage

At this stage, the idea transforms into a product and is being sold. The main goal at this stage is that Ventures tries squeezing between the rests and getting some market shares from the competitors. The management is being monitored by the Venture Capital firms in order to know the capability of the team just to ensure the development process of the product and how they respond to the competitors. If the firms find out that the capabilities are against the competition. Then the Venture Capital might not go to the next stage.

At this stage of financing, working capital is provided for the expansion of the business in terms of growing accounts and inventory.

At this stage, risk factor decreases as the product is not developing at the former start-up stage. But it concentrates on the promotion and sales of the product.

Third Stage

This stage is also called as later stage finance. Capital is provided to an enterprise that has basic marketing set-up, typically for market expansion, acquisition product development etc. At a later stage, ventures try to multiply market shares by increasing the sales of the product and having better marketing promotion.

Venture Capital monitors objectives of earlier stages i.e. second stage and also of the current stage to evaluate whether the team has made the expected cost reduction or not.

Venture Capitalists prefer this stage than any other stages as the rate of failure in the later stage is low. It is also because firms at this stage have a track record of the management, past performance data and established the procedure for financial data.

Risk at this stage is still decreasing because venture relies on the income from the sales of the current product.

IPO Stage

This stage is also known as a bridge finance stage. It is the last round of financing before exit. The Ventures at this stage gain a certain amount of shares which gives them opportunities, such as merger and acquisition, eliminating the competitors, keeping away new companies from the market. At this stage, Venture has to determine the product position, and if possible, reposition it attract the new market.

Advantages of Venture Capital

Expansion of Company: Venture capital provides large funding that a company needs to expand its business. It has the ability for company expansion that would not be possible through bank loans or other methods.

Expertise joining the company: Venture capitalists provide valuable expertise, advice and industry connections. These experts have deep knowledge of specific market standards and they can help you avoid your business from many downsides that are usually associated with startups.

Better Management: It's not always that being an entrepreneur one is also a good business manager. However, since Venture Capitalists hold a percentage of equity in the business. They will have the power to say in the management of the business. So if one is not good at managing the business, this is a significant benefit.

No Obligation to repay: In addition, there is an obligation to repay to investors as it would be in case of banks loans. Rather, investors take the investment risk on their own shoulders because they believe in the company's future success.

Value Added Services: Venture Capitalists provide HR Consultants, who are specialist in hiring the best staff for your business. This helps in avoiding to hire the wrong person. It also offers a number of other such services such as mentoring, alliances and also facilitates the exit.

Disadvantages of Venture Capital

Complex Process: It is a lengthy and complex process which needs a detailed business plan and financial projections. Until and unless the Venture Capitalists are properly satisfied with the business plan, whether or not it will succeed in the future, they won't invest. So securing a deal with a Venture Capitalist can be a long and complex process.

Loss of control: Venture Capital firms add one of their team members to your management team, while this is usually done for ensuring the success of the business, it can also create internal problems.

Loss over decisions: Another big problem faced in Venture Capital funding is that you will have to give up many key decisions on how the company will process or operate. This is because Venture Capitalist are required to be informed about all the key decision relating to business plans, and they usually can override such decision if they are unsatisfied with the decision.

No Confidentiality: Generally Venture Capitalist treat information confidentially. But they refuse to sign non-disclosure agreement due to the legal ramification of doing so. This puts the ideas at risk, especially when they are new. Further, your investor will expect regular information and consultation to check how things are progressing. For example, accounts and minutes of board meetings.

Quick Liquidity: Most Venture Capitalists seek to realize their investment in the company in three to five years. If your business plan expects a longer timetable before providing liquidity, then Venture Capital funding may not be a suitable option for you.

CONCLUSION

As world markets are becoming more and more competitive, thus, it is necessary to choose the right access to human capital to guide and monitor along with the requisite funds necessary for new projects. Venture Capitalists in India have ensured newer avenues and expansion. There are large sectors of the economy that are ripe for venture capital investors like IT, Pharma and other service industries too. Therefore, Venture Capitalists are having positive response to do business in Indian. As there is a risk factor, one should do a thorough study before getting into the process.

RECOMMENDATIONS

To promote and develop the Venture Capital business, the government should provide fiscal relief by exempting the dividend paid to Venture Capital fund investors from income tax.

Venture Capital funds should be made easier by establishing Private Venture Capital funds. It allows funds independently rather than a Joint Venture with banks and financial institution.

Commercial banks should allow categorizing the investment in Venture Capital Funding as “priority sector lending”.

There must be a change in perception that Venture Capital is only for the high tech industry. The Venture Capitalist should seize the opportunities such as biotechnology, food processing, call centers, BPO's, etc. Create profitable disinvestment opportunities as every Venture Capitalist identifies the exit route before it plans for investing in a company.

The role of Indian Venture Capital Association should be strengthened. It should build a database on the Venture Capital industry so as to enable, to disseminate information for those who are interested.

It is essential to create coordinating bodies among technology institutes, as it can provide high-quality manpower which is essential to the success of the industry.