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An Overview on "Venture Capital Financing" in India

Prof. Viren Chavda,
Lecturer,
N. C. Bodiwala Commerce College,
Ahmedabad, Gujarat India

Abstract: The concept of venture capital deals with the great amount of financing to undertake big projects. Venture Capital is money provided by professionals who invest in rapidly growing companies that have the potential to develop into significant economic contributors. According to SEBI regulations, venture capital fund means a fund established in the form of a company or trust, which enhances capital in the form of money through loans, issue of securities, donations or and makes or proposes, to make investments in accordance with these regulations. The funds so collected are available for investment in potentially highly profitable projects at a high financial risk of loss. A Venture Capitalist is an individual or a company who provides. Investment Capital, intellectual management expertise while funding and running highly innovative & prospective areas of products as well as services. . In India, presently, there are many institutions which provide venture capital finance. There is an urgent need for encouragement of risk capital in India, as this will widen the industrial base of, high tech industries and promote the growth of technology. This research paper is an aiming to highlight the issues and challenges faced by Indian venture capital companies while financing.

Keywords: Capital, money, investment, company, SEBI, issues

I. INTRODUCTION

Venture Capital is money provided by professionals who invest in rapidly growing companies that have the potential to develop into significant economic contributors. According to SEBI regulations, venture capital fund means a fund established in the form of a company or trust, which enhances money through loans, issue of securities, or donations and makes or proposes, to make investments in accordance with these regulations. The funds so collected are available for investment in potentially highly profitable projects at a high risk of financial loss. A Venture Capitalist is an individual or a company who provides Investment Capital, Intellectual, Management Expertise, Networking & marketing support while funding and running highly innovative & prospective areas of products as well as services. Thus, the investments made by Venture Capitalists consisting;

- Financing new and rapidly growing projects, enterprises or companies.
- Buying equity and other securities.
- Taking high risk expecting high return on investment.
- Having a long frame of time period, normally of more than 5 to 6 years.
- Marketing and promotions of the product /service being offered

A group of 10 - 15 individuals worked hard to establish the organization. In an attempt to bring together highly influential Indians living across the United States, a networking society named IND US Entrepreneurs or TiE was set up in 1992. The aim was to get the Indian community together and to foster entrepreneurs for wealth creation. The group (TiE) has now more than 600 members with 20 offices across the USA. Some of the eminent personalities belonging to this group are Vinod Dham (father of the Pentium Chip), Prabhu Goel, and K.B. Chandrashekhar is the head of $ 200mn. Exodus Communications, a fiber optic network carrying 30 percent of all Internet content traffic hosting websites like Hotmail, Yahoo and Amazon.

II. VENTURE CAPITAL FIANANCING PROCEDURE

Venture capital starts up with financing to help technically sound, globally competitive and potential projects to compete in the global markets with the high quality and reasonable cost aspects. The growth of South East Asian economies especially Hongkong, Singapore, South Korea, Malaysia along with India has been due to the large pool of Venture Capital investment from domestic or offshore arenas Venture Capitalists draw their investment funds from a pool of money raised from public as well as private capitalists. These funds are deployed collectively as equity capital (ordinary and preference shares capital) and some times as subordinated debt which is a semi secured investment in the company (through debenture) ranking below the secured lenders that often requires periodic repayment. Today, a venture capital deal can involve common equity, convertible preferred equity and subordinated debt in variable proportions. The Venture Capital funding varies across the different stages of growth of a firm. The various stages are as follow:

1. ***Pre seed Stage:*** in this stage small amount of capital is provided to an entrepreneur to dreamt and market a potential idea having better future prospects. The funded work also involves product development to some extent.
2. ***Seed Stage:*** This type of Financing is provided to complete product development and commence initial marketing strategies.
3. ***First Stage:*** Finance is provided to companies to initiate commercial manufacturing and sales.
4. ***Second Stage:*** In the Second Stage of Financing working capital is provided for the expansion of the company in terms of growing accounts receivables and inventory.
5. ***Third Stage:*** Funds provided for major expansion of a company having increasing volume of sales. This stage is met when the firm goes beyond the break even point.
6. ***Later Stage Financing:*** Later Stage Financing is financing a company just before its IPO (Initial Public Offer). Often, bridge finance is structured so that it can be repaid, from the proceeds of a public offering.

There are basically four major elements in financing of ventures which are studied in depth by the venture capitalists. These are as under:

- ***Top Management:*** The strength, expertise & unity of the key people on the board bring significant credibility to the company or enterprise. The members are to be mature, experienced having working knowledge of business and capable of taking potentially high risks against high return on venture investment.
- ***Realistic Financial Requirement and Projections:*** The venture capitalist requires a realistic view about the present financial position of the organization as well as future projections regarding scope, nature and performance of the company in terms of scale of operations, operating profit and further costs related to product development through Research & Development.
- ***Expectation for Capital Gain:*** An above average rate of return of about 30% to 40% is required by venture capitalists. The rate of return also depends upon the stage of the business cycle where funds are being deployed. Earlier the stage, higher is the risk and hence the return on it.
- ***Owner's Finance:*** The financial resources owned & committed by the entrepreneur/ owner in the business including the funds invested by family, friends and relatives play a very important role in increasing the viability of the business. It is an important avenue where the venture capitalist keeps an open eye.

III. VENTURE CAPITAL FUNDING IN INDIA

In India the Venture Capital plays a exigent role in the development and growth of innovative entrepreneurships. Venture Capital activity in the past was possibly done by the developmental financial institutions like IDBI, ICICI and State Financial Corporations. These institutions promoted entities in the private sector with debt as an instrument of financing. Funds raised from public were used as a source of Venture Capital. But it was depended a lot on the market vagaries. And with the minimum paid up capital requirements being raised for listing at the stock exchanges, it became difficult for smaller firms with viable projects to raise funds from public.

In India, the need for Venture Capital was recognised in the 7th five year plan and long term fiscal policy of Govt. of India. In 1973 a committee on Development of small and medium enterprises highlighted the need to faster venture capital as a source of funding/financing new entrepreneurs, projects and technology. Venture capital financing was actually started in India in 1988 with the formation of Technology Development and Information Company of India Ltd. (TDICI) - promoted by ICICI and UTI. The first private venture capital fund was sponsored by Credit Capital Finance Corporation (CFC) and promoted by Bank of India, Asian Development Bank and the Commonwealth Development Corporation viz. Credit Capital Venture Fund. At the same time Gujarat Venture Finance Ltd. and APIDC Venture Capital Ltd. were started by state level financial institutions. Sources of these funds were the financial institutions, foreign institutional investors or pension funds and high net-worth individuals. The major venture capital financers in India are:

- Gujarat Venture Finance Ltd.
- SBI Capital Venture fund.
- PICUP.
- ICICI
- TDICI
- IDBI's Venture Capital Fund.

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- Credit Capital Venture Fund(India) ltd.
- Cabank VC fund

IV. ISSUES AND PROBLEMS IN VENTURE CAPITAL FUNDING

Venture Capital Financing is in its abortive stages in India. The emerging global competitiveness has put an immense pressure on the industrial sector to improve the quality level with minimization of cost of products by making use of latest and advanced technology. The implicationis to obtain adequate financing along with the necessary hi-tech equipments to produce an innovative product which can succeed and grow in the present market condition. Unfortunately, India lacks on both fronts. The reqiured capital can be obtained from the venture capital firms who expect high and risky rate of return on the investment. The financing firms expect a sound, experienced, mature and capable management team of the company being financed. Since the innovative project involves a higher risk, there is an expectation of higher returns from the project. The payback period is also long (5 to 7 years). The various issues and difficulties of venture capital financing are as follow;

- Requirement of an experienced managerial team
- Requirement of high rate of return on investment
- Payback period is normally long
- Uncertainty regarding the success of the product in the market.
- Problems and issues regarding the infrastructure details of production like plant location, accessibility, relationship with the suppliers and creditors, transportation facilities, labour availability etc.
- The category of potential customers regarding products and service offerings.
- The size of the market
- Major rivals and their market share.
- Financial considerations like return on capital employed (ROCE), cost of the project, the Internal Rate of Return (IRR) of the project, total amount of funds required, ratio of owners investment (personnel funds of the entrepreneur), borrowed capital, mortgage loans etc. in the capital employed

V. FEASIBILITY OF VENTURE CAPITAL FINANCING

With emergence of liberalization, India has been showing remarkable growth in the economy in a past decade. The government is promoting growth in capacity utilization of available and acquired resources and hence entrepreneurship development, by liberalising regulations regarding venture capital financing. But only eight domestic venture capital funds were registered with SEBI during 1996-1998, which increased to 14 funds in 1999-2000. Institutional interest is growing and foreign venture investments are also increasing. Many state governments have also set up venture capital funds for the IT sector in partnership with the local state financial institutions and SIDBI. These include Andhra Pradesh, Karnataka, Delhi, Kerala and Tamil Nadu etc.

In the year 2000, the finance ministry announced the liberalization of tax treatment for venture capital funds to promote them & to increase employment opportunities. This is expected to give a strong boost to the non resident Indians located in the Silicon valley and elsewhere to invest some of their capital, knowledge and enterprise in these types of ventures. A Bangalore based media company, Graycell Ltd., had obtained venture capital investment totaling about $ 1.7mn. The company would be creating and marketing branded web based consumer products in the near future. The following topics can be considered as the predictions of venture financing in India.

- International competitive human resource capital.
- Second Largest English speaking, scientific & technical manpower in the world.
- Existance of larage ongoing scientific and technical research carried by large number of research laboratories.
- Existence of a international competitive high technology
- Initiatives taken by the Government in formulating policies to encourage investors and entrepreneurs.
- Initiatives of the SEBI to develop a strong and vibrant capital market giving the required liquidity and flexibility for investors for entry and exit

VI. CONCLUSION

The world markets are becoming more and more competitive. Companies are required to be super efficient with respect to cost, productivity, labour efficiency, technical skills, varied consumer demand, adaptability and foresightedness to get competitive edge over the rival firms. There is an imminent demand for highly cost effective, quality products and so, the need for right access to valuable human capital to guide and monitor along with the necessary funds for financing the new projects. Today India is promoting venture capital financing to new projects, innovative ideas, liberalising taxation regulations providing tax benefits to

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venture capitalist. There are large sectors of the economy that are ripe for venture capital investors,like, information technology, engineering, Pharma, Manufacturing industries and other service industry too. The nation waits for the rapid venture capital funding business in India inspite of the existing problems in the Indian industrial infrastructure.

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