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VENTURE CAPITAL FINANCING & INNOVATIVE SKILLS OF INDIAN ENTREPRENEURS

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Abstract

Entrepreneurs often struggle to find institutional start-up capital, and angel capital is often either not available or focused on service businesses with lower risk and quicker revenue streams. To help entrepreneurs overcome this financing hurdle, emerging market governments are pursuing a number of strategies to provide needed access to infrastructure, coaching and capital. Entrepreneurship tends to be innovation-driven and will also help generate solutions to India's myriad social problems including high-quality education, affordable health care, clean energy and waste management, and financial inclusion. The economic and social benefits of thriving entrepreneurship and innovation are evident, it is critical to recognize that an entrepreneur needs address on early stage Venture Capital Funds (say up to Rs 500 crore) from domestic capital especially through institutional investors as a large part of VC investments in India is through offshore funds that have traditionally not invested at the seed stage (planning commission report, 2012).

Key words: Entrepreneurship, innovation-driven, Venture Capital Funds

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Introduction:

Venture capital (VC) is an important financial innovation in financing early-stage, high-potential, high-risk, technology oriented growth companies. Venture capital is a recent concept in the emerging markets. (Pandey et al., 1996). Venture capitalists create value through their role as active investors, in promoting economic development and technological progress. Venture capitalists provide equity financing rather than loans to young companies in exchange for part ownership (private equity capital as seed or growth funding of the company). Thus, entrepreneurs avoid interest payments and can achieve profitability more quickly (Biekpe, 2001). For venture capitalists, the realization of profits usually comes in the form of public listing or trade sale (Bleackley et al, 1995). India has registered a significant growth in terms of the amount and number of venture capital funds. Venture capital in India has shown interest in Non-data, non-voice mobile phone applications, Internet-based technologies, Growth-stage businesses in real estate, Late-stage businesses in the retailing sector, Language-based Internet applications, like text-to-voice conversion into vernacular, Pharma, Sports and wellness/healthcare sector. In first quarter of 2012, 57 Indian companies received venture capital funding.[1] The role of Venture capital financing in India has been immense in terms of innovation and investment leading to the development of entrepreneurship skills and economy.

Objectives of the study:

1. To understand the concept, evolution structure and growth of Venture capital financing Industry in India.
2. To review the different exit strategies of Venture Capital financing Firms.
3. To analyze the impact of Venture Capital Financing in terms of participation of Venture Capital in Entrepreneurship Projects in India .

Theoretical background:

Venture Capital plays a vital role in the development and growth of innovative entrepreneurships. Venture Capital activity in the past was 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 funding. For a long time funds raised from public were used as a

[1] http://www.preqin.com/docs/reports/Preqin_Special_Report_Venture_Capital_May12.pdf

source of Venture Capital. This source however depended a lot on the market vagaries. As the minimum paid up capital requirements was 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 recognized in the 7^{th} five year plan and long term fiscal policy of GOI. In 1973 a committee on Development of small and medium enterprises highlighted the need to VC as a source of funding for new entrepreneurs and technology. VC financing really 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 VC 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. Venture funds in India can be classified on the basis of the type of promoters.

1. **VCFs promoted by the Central govt.** controlled development financial institutions such as TDICI, by ICICI, Risk capital and Technology Finance Corporation Limited (RCTFC) by the Industrial Finance Corporation of India (IFCI) and Risk Capital Fund by IDBI
2. **VCFs promoted by the state government**-controlled development finance institutions such as Andhra Pradesh Venture Capital Limited (APVCL) by Andhra Pradesh State Finance Corporation (APSFC) and Gujarat Venture Finance Company Limited (GVCFL) by Gujarat Industrial Investment Corporation (GIIC)
3. **VCFs promoted by Public Sector banks** such as Canfina by Canara Bank and SBI-Cap by State Bank of India.

4. **VCFs promoted by the foreign banks or private sector companies and financial institutions** such as Indus Venture Fund, Credit Capital Venture Fund and Grindlay's India Development Fund.

Corporate Venturing:

Corporate venture capital (CVC) has been practiced for more than 40 years and historically accounted for 6% to 10% of all VC globally. Share of the VC pie grew during the dot-com peak of 1999–00, since then, CVC has returned to its historic share, with the exception of cleantech, where CVC accounts for a slightly greater proportion of all venture capital (10% to 15%). In India, big local corporations are beginning to challenge the local VCs and their foreign CVC colleagues. The major players are giants (e.g., Tata, Wipro, Infosys, and Reliance) and leaders in their industries. They look for strategic access to new technologies, business models and entrepreneurs in their highly competitive markets, balancing strategic with financial objectives.

Venture capital is experiencing problems in its traditional markets. As the valuations in North America have risen for both early-stage and later-stage investments, making it much harder to make great returns. Most venture-capital firms do not head abroad with the sole aim of backing tested concepts, Douglas Leone of Sequoia Capital, a big venture-capital firm, reckons that in emerging markets like China around 50% of start-ups backed by foreign venture capitalists in the internet and mobile sectors used tested concepts, and in markets like Brazil it is closer to 70%.This mitigates the risk inherent in start-ups and means companies are likely to grow quickly, because the original firm has already worked out the kinks. Often the originator of the business does not have the expertise to enter new countries quickly, they can also gain an edge by tailoring businesses to local habits. **Flipkart**, an online-commerce site in India founded by two former Amazon employees, has received funding from Tiger Global, a New York-based hedge fund that specializes in this kind of investing, and Accel Partners, a venture-capital firm. Flipkart has taken off in part because credit cards are less common in India and it offers the option of payment on delivery. This push into emerging markets has gained momentum.

Review of literature:

There is an extensive body of literature covering role of venture capital financing in developed countries like United States and the United Kingdom where the Industry has been historically more active, but in India, the venture capital investment in India was seen post-liberalization. There was a continuous increase till 2001 and thereby drastically reduced. Surprisingly, there was a negative growth of 4 percent in 2001-02 it was continued and a 54 percent drastic reduction was recorded in the year 2002-2003. Since 2005, there venture capital financing has been at an increasing rate in India.Success stories of venture backed companies leading to substantial financial gains made by venture capitalists evoked interest in academic research in this area.

Amit et al., (1990), Commercial banks and other lending institutions required an established track record and collateral before considering any application for funds. This attitude of financial institutions has always left a funding gap for potentially viable ventures with either insignificant collateral to offer or little history of success. Therefore, 'risk sharing and lack of funds drive entrepreneurs to seek venture financing'.

Fried and Hisrich (1994), concluded that venture capitalists use three generic screening criteria for investments: the viability and novelty of the project; the integrity, track record and leadership skills of management; and the possibility for high returns and an exit, before proceeding to detailed evaluation.

Thompson et al. (1997) found that venture capitalists are becoming proactive in identifying management buy-outs, investor led buy-out, and divestment candidates, resulting from corporate refocusing programmes.

Zider (1998), Venture capitals niche exists because of the structure and rules of capital markets.

Folster (2000) argues that many countries support the creation of new firms, based on the presumption that the total number of jobs increases when a person moves from unemployment or regular employment to self-employment. Small firms have made a significant contribution in introducing innovative products, generating employment, payment of taxes to the Exchequer and so forth. Thus their share in the Gross Domestic Product has invariably been vital.

Groh, A. P. and Von Liechtenstein, H. (2011), contributed to the knowledge of the capital flow from institutional investors via venture capital (VC) funds as intermediaries to their final destination, entrepreneurial ventures. They found the top criteria to be the expected deal flow and access to transactions, a VC fund's historic track record, his local market experience, the match of the experience of team members with the proposed investment strategy, the team's reputation, and the mechanisms proposed to align interest between the investors and the VC funds. Venture capital (VC) funds focus on ‘Local Expertise and Incentive Structure’, ‘Investment Strategy and Expected Implementation’, and ‘Prestige/Standing vs. Cost’ as a selection criteria.

According to the latest PwC MoneyTree™ India report, private Equity (PE) firms invested US$ 2.5 billion across 97 deals in Q3’12. Quarterly PE investments increased by 32% in terms of value, while the deal volume decreased by 8%, as compared to the previous quarter (i.e., Q2 ’12). In comparison with Q3 ’11, there has been a 4% incremental rise in value and a drop of 20% in the number of deals.[2] According to Sanjay Dhawan, PricewaterhouseCoopers India Pvt Ltd, “The IT & ITeS sector typically receives a higher volume of deals but of lower value---since many deals are early-stage investments where the startup companies do not require huge funding. Moreover, with many PE firms focusing on the SME services segment, and with the industry moving towards Tier 2 and 3 cities, this trend will continue for the next few years. Hence, the sector will remain attractive to investors.", also "The continued interest in online services companies by PE

[2] http://www.pwc.com/gx/en/technology/moneytree/private-equity-vc-investing-in-india.jhtml

investors reflects the maturity of the products and services of these companies. One can expect a few of these companies to grow and have a global footprint in the near future."

Findings of the study:

There were 176 deals during 2011, a marked increase from the 99 venture capital financings in India during 2010.

In Q_1 2012, 57 Indian companies received venture capital funding; a 35% increase in deal activity from the previous quarter, and more than double the number of deals in the country seen two years earlier in Q_1 2010.

India has seen more fluctuation in financing levels. In 2010, 3% of the global total was invested in companies in India. This figure fell slightly in 2011, but in the year so far over 4% of the global aggregate value has been invested in the country.

In 2012 to date, 16% of the total number of venture capital deals announced globally has been angel/seed financings into very early stage companies. Series A, financings accounted for a similar proportion of commitments; **15%** of all venture capital deals fell into this early stage, while follow-on early stage Series B deals accounted for **10%** of the total number of deals. The deals were less as **6%** in later stage financings, with Series C and just **4%** of the total number of deals classed as Series D or later.

Around 7% of deals in 2012 have been add-ons, with venture debt and growth capital deals each accounting for just 4% of the total number of deals. **61%** venture capital firms focus on early stage investments, while **23%** focus on later stage/expansion investments and **1%** focuses on venture debt. The venture industry in emerging markets like these has not embraced early-stage technology investments.

Entrepreneurs often struggle to find institutional start-up capital, and angel capital is often either not available or focused on service businesses with lower risk and quicker revenue streams. To help entrepreneurs overcome this financing hurdle, emerging market governments are pursuing a number of strategies to provide needed access to infrastructure, coaching and capital. Entrepreneurship tends to be innovation-driven and will also help generate solutions to India's myriad social problems including high-quality education, affordable health care, clean energy and waste management, and financial inclusion. The economic and social benefits of thriving entrepreneurship and innovation are evident, it is critical to recognize that an entrepreneur needs address on early stage VC Funds (say up to Rs 500 crore) from domestic capital especially through institutional investors as a large part of VC investments in India is through offshore funds that have traditionally not invested at the seed stage (planning commission report, 2012).

Conclusions:

Venture Capital Financing Industry had shown a good progress in terms of participation as an investment, number of deals, providing a vote of confidence in economy and its overall prospects. It is believed that there interests are aligned with the overall interests and development of the economy. They tend to make higher profits if economies grew faster and their portfolio companies grew more profitable. Therefore it is in the interest of the Government to attract such Capital. Along with development of entrepreneurship skills, such capital can be used for BOT (Build, Own and Transfer) and Public-Private Partnerships for long gestation projects. The Present Era is an, evolution that provides new opportunities for venture capital investors, corporate investors and innovative entrepreneurs allowing industry to continue making essential contributions to innovation and job creation worldwide.

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