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# DETAIL STUDY ON VENTURE CAPITAL FINANCING IN INDIA

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**Abstract**

*Finance is said to be a key factor in industrial development of a country, finance works as a life blood of a business, and hence the development of any organisation depends on the availability of finance with it. In order to meet the financial needs of entrepreneurs with sound and innovative business proposals, venture capitalist not only invests money into such proposal, they will also assist the entrepreneurs in decision making. Venture capital is an external source of finance to the entrepreneurs. The venture capital offers its wings of financial and managerial support to entrepreneur with the sound business plans which involves high risk meanwhile promises high possible returns and promising future growth. Venture capital broadly implies an investment of long term, equity finance in high risk projects with high possible rewards. The role of venture capital in innovation and creativity is very significant as it promotes entrepreneur's innovative and creative business plans by providing seed finance. Here, an attempt is made to explain, how venture capital financing works? In how many ways one can get access to venture capital finance? How important venture capital is for an entrepreneur? And at what stage of business one gets venture capital assistance? And with all that, an effort is also made to describe the regulatory aspects of venture capital financing in India.*

**Keywords:** Venture Capital Financing, Entrepreneurship, Innovation, Industrial Development, Investment.

## INTRODUCTION

Venture capital is an external source of finance to the entrepreneurs. The venture capital offers its wings of financial and managerial support to entrepreneur with the sound business plans which involves high risk meanwhile high possible returns and promising future growth. Venture capital is a form of equity financing in which the fund manager actively participates in the venture being financed. The venture capitalist directs the flow of funds in such a venture that has high growth potentials and promising returns. The risk element in venture capital financing is very high and the possibilities of earning return on the investment will also be very high but uncertain. Venture capitalist is responsible for managing the investor's fund and assisting the entrepreneur by providing finance and managerial assistance. Venture capital financing plays a vital role in the technological and industrial development of a country especially in the developing countries like India. Developing Indian economy has witnessed the progress of venture capital activities in recent days.

## ORIGIN OF VENTURE CAPITAL FINANCING IN INDIA

The process of venture capital financing has basically started in USA and hence it is called the birth place of venture capital financing. However, in India a committee on development of small scale and medium entrepreneurs urged the development of venture capital in India in 1972. The committee is popularly known as "Bhatt Committee". The committee recommended the creation of venture capital to help the new entrepreneurs and technologist in setting up enterprises. This was the beginning to venture capital financing in India, since then remarkable changes have been seen in Indian venture capital financing activities. A brief summery on the development of venture capital financing after 1972 has been explained as below.

- Risk Capital Foundation is the first venture capital fund launched in 1975 by IFCI (Industrial Finance Corporation of India); this fund was aimed at supplementing promoters' equity to promote the new industries. In the year 1988, Risk Capital Foundation was renamed as Risk Capital and Technology Finance Corporation Ltd.
- Seed capital scheme is the venture capital fund and was introduced by IDBI (Industrial Development Bank of India) in 1976 to promote the new industries.
- ICICI setup venture capital scheme in the year 1986 with a view to encourage the technocrats in the private sector to enter into new fields of high technology.
- In the year 1988 ICICI in association with Unit Trust of India (UTI) formed a venture capital subsidiary named Technological Development and Information Company Ltd (TDICI) to take over the venture capital financing activities of ICICI Ltd. TDICI is now popularly known as ICICI Venture Funds Management Company Ltd based in Bangalore.

- The venture capital financing of India experienced a strong base in 80's the result of which showed a big change in Indian venture capital financing activities.
- As on 31st March, 2012 there are 208 Venture capital funds are registered with SEBI and are operating throughout India.
- The key advantages of having Venture Capital in an economy are
- It facilitates Capital formations by injecting long term equity finance for solid future growth of a company.
- Venture capitalist as a business partner share both risks and rewards, hence the venture capitalist minimizes the entrepreneur's risk of big losses.

- Venture capitalist helps and supports the entrepreneur in managerial decision making and plays a vital role in tackling critical problems.
- It motivates and supports innovative business proposals and helps in maximum utilisation of resources.

**REGULATION ON VENTURE CAPITAL IN INDIA**

Venture capital activities in India are regulated by SECURITIES AND EXCHANGE BOARD OF INDIA (VENTURE CAPITAL FUNDS) REGULATIONS, 1996. The regulation was enforced in 1996 and it lays down all obligations and restrictions related to venture capital financing in India.

**WORKING OF VENTURE CAPITAL FINANCING**

Venture capital funding is a process, where the pooled investments of angel investor will be made available to money seekers to support their sound business ideas. Procedure for Venture capital financing can be described as:

1. The investors invest money (subject to SEBI (Venture capital funds) Regulations, 1996) in a venture capital fund.
2. The domestic venture capital fund must get the certificate of registration from SEBI for carrying any venture capital activity.
3. The fund is generally created as a trust and the fund will be invested in a predetermined sector subject to SEBI (Venture capital funds) Regulations, 1996.
4. These funds are generally managed by Asset Management Company
5. Finally, the generated returns on the investments (ROI) of the trust are distributed among the investors.

**IMPORTANCE OF VENTURE CAPITAL FINANCING IN INDUSTRIAL DEVELOPMENT**

The changing technological and political environment of last few decades suggests that venture capital firms are significantly contributing to the success of start-up companies as well as economic growth of nation.

**LONG TERM SOURCE OF FINANCE**

Venture capital financing is a long term investment process. Venture capitalist provides a strong capital base for future growth of a company. Basically the investments made by venture capitalist will be long term in nature. They keep their investments with company until it grows up and enters into capital market.

**MANAGERIAL SUPPORT**

Role of venture capital financing is very vital in the development of industries not because of financial assistances but also for managerial support to entrepreneurs. Venture capitalist actively participates in managerial activities and helps Investee Company to choose a better alternative among many.

**BUSINESS PARTNER**

Venture capitalist promotes a good business plan by providing finance and takes an active participation in the management of the company as well as provides the expertise and qualities of a good banker, technologist and a good manager. The prime objective of the venture capitalist is gain high returns and they literally acts as a good partner to the entrepreneur.

**TECHNOLOGICAL DEVELOPMENT**

According to a Report of the Committee on Innovation and Technology, the technology ventures can go through several stages of maturation, each one with a different type of financial requirement, the very early stage financing is seldom provided by venture funds and often comes from angel investors, a category that can, in principle include official agencies that provide low cost seed capital. Hence, the venture capital plays a critical role in technology innovation and development.

**PROMOTES INNOVATION**

Venture capital financing differs from the traditional methods of borrowing and lending money. Venture capitalist invests in such a business which promises the future growth and a high profitability, most of the innovative proposals are preferably taken up and will be invested with the financial, technical and managerial assistance until the firm grows up and capable of being entered into stock market.

**METHODS OF VENTURE CAPITAL FINANCING**

Venture capitalist will have two passions viz. risk and rewards. All their decisions are met by balancing one against the other. The various methods of venture capital financing in India is presented as below.

**EQUITY PARTICIPATION**

This is the most common method of venture capital financing. Under this method venture capitalist invests their financial and managerial efforts by obtaining equity share capital of the firm. The effective control and ownership of the venture remains with the entrepreneur and the proper inputs will be given by the venture capitalist at right time. Their main intention behind the equity participation is to make huge capital gains by selling the investment either to the promoters or to the general public. This method favours the venture capitalist to earn the high returns on their investment and facilitates the investors for an active participation in management activities of the firm.

**CONVENTIONAL LOAN**

Under this method venture capitalist invest money in new venture for the fixed percentage of interest. This method would be the most unsuitable form of financing risky ventures.

**CONDITIONAL LOAN**

This is the another method of venture capital financing, here the venture capitalist invest their money into the new business as loan, the investee has to pay no interest against the loan rather it needs to pay the royalty ranging from 2% to 15% of the sales and the rate of royalty and the payment schedule is decided after looking gestation period and the repayment capacity of the firm. The sale of the investee company determines the royalty of the venture capitalist. Once the company starts generating huge sale and yield high turnover, the promoters opt for the high rate of interest (20% P.A) as an alternative of royalty on sales. Under this method venture capitalist earns fewer returns on investments as compare to equity participation method.

**INCOME NOTES**

This method is the combination of both conditional and conventional methods of venture financing. Under this method of financing, an entrepreneur is liable of paying both fixed rate of interest and royalty on sales. It is a unique method followed by venture capitalist where they get interest and royalty substantially at lower rate.

**OTHER FINANCING METHODS**

Indian financial system started witnessing new practices in venture capital followed by some venture capitalist like participation in fully or partly convertible debenture and participation in cumulative convertible preference share, etc.

**STAGES OF VENTURE CAPITAL FINANCING**

It is very common that every enterprise passes through different stages of business life cycle. Hence, there are different stages of investment entries to venture capitalist; different venture capital firm has a different kind of attitude towards the venture capital investment. The stages of venture capital financing can be divided as follows:

**SEED FINANCE STAGE**

This is the first stage of venture capital financing, where the entrepreneur conceptualizes and develops his/her vision for the innovative venture. It is the very initial stage of the firm, actual business production does not take place at this stage.

**START-UP FINANCE STAGE**

At this stage entrepreneur seeks finance to establish and to start-up business activities. In this stage all the initial steps were being taken for commencing the business operations. The risk involvement will be very high for venture capitalist, but the valuable inputs of venture capital helps entrepreneur to operationalize the business activities.

**GROWTH STAGE**

Venture capital financing may take place when entrepreneur seeks financial assistance. Under this stage the business activities of the firm get start with a positive return and hence the venture capitalist prefers to invest in the companies that have started a positive cash flow or earnings.

**EXPANSION STAGE**

This is another stage where the venture capitalist invests their vital inputs for the business development. The financial insufficiency of the entrepreneur will be met by the venture capitalist for the business expansion.

**BRIDGE/ PRE-PUBLIC STAGE**

In general, this is said to be the last stage of venture capital financing. At this stage the firm gains certain market share, in order to exit the investments with venture the venture capitalist helps promoter to go public and they (venture capitalist) divest their share for a high return.

**CONCLUSION**

Indian financial system is witnessing many changes, in this unstable economic environment venture capital financing is positively emerging and also mobilising economy of the nation. Development and growth of industries can be achieved by providing needful capital; venture capital financing is becoming a trendy business to the one, who is ready to bear the heavy risk and high reward. Venture capital financing in India can be found in the various sectors such as IT sector, Telecom, Media and entertainment, Health care sector, Real estate, BFSI and many others. The risk element in these sectors is very high, in order to minimize the risk of investment losses many investors do not like to invest in risk involved ventures but venture capitalist takes a stand and contributes to the development of risky venture. Therefore, venture capital financing is playing a key role in the development of industrial sector and contributing to economic development of the nation.

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