₹ 200 ISSN - 2249-555X

Volume : 1 Issue : 6 March 2012

Indian Journal Of Applied Research

Journal for All Subjects

www.ijar.in

Listed in International ISSN Directory, Paris.

ISSN - 2249-555X

Indian Journal of Applied Research

Journal for All Subjects

1. Thoughts, language vision and example in published research paper are entirely of author of research paper. It is not necessary that both editor and editorial board are satisfied by the research paper. The responsibility of the matter of research paper/article is entirely of author.
2. Editing of the Indian Journal of Applied Research is processed without any remittance. The selection and publication is done after recommendations of atleast two subject expert referees.
3. In any condition if any National/International University denies accepting the research paper published in IJAR, then it is not the responsibility of Editor, Publisher and Management.
4. Only the first author is entitle to receive the copies of all co-authors
5. Before re-use of published research paper in any manner, it is compulsory to take written permission from the Editor-IJAR, unless it will be assumed as disobedience of copyright rules.

5. All the legal undertaking related to Indian Journal of Applied Research is subject to Ahmedabad Jurisdiction.

7. The research journal will be send by normal post. If the journal is not received by the author of research papers then it will not be the responsibility of the Editor and publisher. The amount for registered post should be borne by author of the research paper in case of second copy of the journal.

Editor,
Indian Journal Of Applied Research
8-A, Banans, Opp. SLU Girls College, New Congres Bhavan, Paldi,
Ahmedabad-380006, Gujarat, INDIA
Contact.: +91-9824097643 E-mail : editor@ijar.in

INDEX

Volume : 1 | Issue : 6 | March 2012 ISSN - 2249-555X

Research Paper Management

Stimulation of Entrepreneurship through Venture Capital in India

* Vijayakumar ** Subrahmanya K C

* Senior Research Fellow, Karnatak University, Pavatenagar, Dharwad

** Lecturer, MBA Department, Global Academy of Technology, Rajarajeshwarinagara, Ideal Homes Township, Off. Mysore Road, Bangalore

ABSTRACT

It is no doubt that India witnessed phenomenal economic growth in the past two decades. It is also amply clear that this growth was fuelled by enormous growth of secondary and tertiary sectors. The Venture capital financing has been instrumental in stimulating entrepreneurial activities in the country. This paper makes an attempt to examine the potential for further stimulation of entrepreneurship through Venture capital in India.

The paper takes a brief look at the basics in venture capital financing, its introduction and growth of Venture capital financing in India, industries which benefitted from Venture capital financing and major VC Funds in India. In the later section it gives a brief description of the important recommendations of KB Chandrashekhar Committee on Venture Capital formed by SEBI.

Keywords : India, Venture Capital, Venture Capital Financing, Entrepreneurship Stimulation

Introduction

Venture capital firms differ in size, geographic focus, industry specialty, and funding stage. Most firms stay closely involved with their portfolio companies, taking board positions, recommending management candidates, providing advice, and identifying valuable contacts. Entrepreneurs approaching venture capitalists must have a business plan; however, it should be short and concise, rather than presenting the business in full detail because venture capitalists will conduct exhaustive due diligence. The plan should spell out the amount of funding the entrepreneur is seeking but should not detail the terms.

Venture capitalists consistently emphasize the importance of the management team in an entrepreneurial venture and focus much of their due diligence on the key people involved. They assert that a good idea is only executable when implemented by a top-notch executive team. Personal introductions are the best way to give your plan a chance. Use your network to find mutual acquaintances. These introductions give both sides an immediate reference point and raise your request above the incoming noise.

Basics of Venture Capital Financing (VCF)

Though it is commonly understood to be financing of tech based units, but it actually has a more broad based scope of functioning. Starting and growing a business always require capital. There are a number of alternative methods to fund growth. These include the owner or proprietor's own capital, arranging debt finance, or seeking an equity partner, as is the case with private equity and venture capital. Private equity is a broad term that refers to any type of non-public ownership equity securities that are not listed on a public exchange. Private equity encompasses both early stage (venture capital) and later stage (buy-out, expansion) investing. In the broadest sense, it can also include mezzanine, fund of funds and secondary investing.

Venture capital is a means of equity financing for rapidly-growing private companies. Finance may be required for the start-up, development/expansion or purchase of a company. Venture Capital firms invest funds on a professional basis, often focusing on a limited sector of specialization (eg. IT, infrastructure, health/life sciences, clean technology, etc.). The goal of venture capital is to build companies so that the shares become liquid and provide a rate of return to the investors that is consistent with the level of risk taken. With venture capital financing, the venture capitalist acquires an agreed proportion of the equity of the company in return for the funding.

Features of VCF

Given below are some of the features of venture capital –

- **Finance through equity participation**

VCF involves providing finance in the form of equity (risk capital) to unlisted companies, non conventional units, new ventures based on innovative entrepreneurship, young and rapidly growing companies that have the potential to grow into significant economic contributors, new tech based professionals and untried areas ventured by entrepreneurs. Such business/units are normally characterized by high risk, high returns.

- **Long term investment**

It serves as an important source of equity for start up companies. There is no security or collateral in VCF. The venture investor normally stays with the venture unit until it is able establish and be on its own. Typically a VCF company continues with the entrepreneur/investee company up to 2 to 8 years before it exists. In some cases it has even extended to over 10 years.

- **Management participation**

The VCF company not only provides funds but also management counselling. It works as a partner with the entrepreneur. It helps companies in accessing further capital – whether from other VC investors, equity capital markets or loans from financial institutions.

VC investors also forge active partnerships with their investee companies to enhance their visibility, open up new business opportunities and improve efficiency in terms of increasing revenues, profits, exports and R&D, controlling costs, and also improve corporate governance.

- **Angel**

An 'Angel' in the context of VCF, represents an experienced individual/group of individual/association of individuals, who is/are a professional/s with high net worth, with less money orientation, takes/take risk and provides/provide the first round of finance. He/it serves as an important link in the process and supports the enterprise.

Steps in Venture Capital Financing
Successful venture capital funding is a process of reducing perceived risk to the lowest possible level. The funding source has fiduciary responsibility to its investors. This requires a thorough "due diligence review" of all aspects of your business. Venture capital sources will often require you to justify every assumption made for a projection five years into the future.

Your business plan must show the investment parameters requested, as well as a plan to liquidate the investor's position (the exit strategy) at a later date by a payback formula, initial public stock offering (IPO), or plans for a merger/buyout by a major company.

- ✓ **Evaluation of the business plan**
- ✓ **Valuation of the deal**
- ✓ **Structuring the deal**
- ✓ **Valuation of portfolio and Exit**

Stages of Financing
The VCF is divided into the following stages.

- ➢ **Early stage financing**
  - o Seed capital (pre start up)
  - o Start up
  - o Second round financing

- ➢ **Later stage Financing**
  - o Mezzanine/development capital
  - o Bridge/expansion
  - o Buyouts- MBO's and MBI's
  - o Turnarounds

- ➢ **Exit options for investors**
  - o Following exit options are normally available for a VC investor.
  - o Going public (IPO)
  - o Sale of shares (stake of the VC investor) to the entrepreneur or employees
  - o Trade sale
  - o Sale to a new investor (takeout)
  - o Liquidation

Introduction and growth of venture capital financing in India
Originally VCF started in India by development financial institutions when in 1975 the IFCI sponsored Risk Capital Foundation (now called IFCI venture capital funds Ltd). This was followed soon by the introduction of seed capital scheme by IDBI in 1976. Until 1984 they continued provision of seed and risk capital. But due to lack of precisely laid down principles and professional expertise both incurred heavy losses.

Thanks to initiatives by the GOI, the VCF took off as an industry in a new way with ICICI ventures being the first VC institution in the country. It was soon followed by many more VC funds sponsored by government (central/state) and others by the private sector. The foreign VC companies are also allowed now in India.

Industries which benefited from venture capital financing
The industries which benefitted by VCF include biotechnology/healthcare, electrical, electronics & communication, energy, environment, materials, manufacturing/ control technologies and financial/security services.

After amendment by SEBI of VC financing norms in 2004 some more industries were included within the ambit of VCF. They include real estate, equipment leasing and hire purchases, gold financing, IT and IT-enables services, software products (Mainly Enterprise-focused), wireless/telecom/ semiconductor, banking, PSU disinvestments, Media/entertainment, Bio technology/bio informatics, pharmaceuticals, manufacturing and retail.

Major VCF's in India
The sate sponsored VC funds include APDIC venture capital ltd, Hyderabad, Gujarat venture finance limited (GVFL), IL&FS investment managers limited (IIML), SIDBI venture capital limited (SVCL), IFCI venture capital Funds Ltd. (IVCF), ICICI venture funds management company limited, Karnataka information technology VC fund, Tamilnadu technology fund, Orissa VC fund, UP venture fund, SICOM Mumbai, Punjab Infotech venture fund and 12 VC funds by SIDBI at state and regional levels.

The private sector VC companies include KOTAK private equity group (KPEG), IDG ventures India, MOTILAL OSWAL, ascent, Aditya Birla capital advisors, TVS capital, reliance, silicon valley bank etc.

The foreign VC companies include earnest and young, axis bank, KPMG, black stone group, standard charted etc.

Growth of VC in India
The VC investment in India grew from 50 crores in 1996-97 to 50,000 crores in 2007-08. The VC investment in 3rd quarter of 2010 was $144 million (across 31 deals) as compared to $128 million (across 24 deals) in the preceding quarter and $122 million (across 27 deals) in 3rd quarter of 2009. Total VC investment for 2010 was $395 million (across 77 deals) and that for 2009 was $273 million (across 71 deals).

Early stage investments accounted for 71% of the investments in volume terms (compared to 68% in the immediate previous quarter), IT and ITES accounted for 55% of the investments in volume terms, and 53% of the investments in value terms for the 3rd quarter of 2010. 13 deals were in the range of 5-10 US$M, 9 in the range of 2-5 US$M and 7 in the range of 0-2 US$M.

The industries include IT and ITES (including online services, mobile VAS, enterprise software among others), engineering and construction, BFSI, education, health care and life sciences, energy, retail, agribusiness and other services.

Important recommendations of KBC Committee.
To give a boost to Indian VC industry SEBI formed a special committee in 1999-2000 under the chairmanship of Sri. K B Chandrashekar. Some important recommendations of the committee are

- SEBI should be the nodal regulator for VCF's to provide uniform, hassle free, single window regulatory framework.
- VC fund should be entitles to automatic tax pass through at the pool level while maintaining taxation at the investor level without any other requirement under Income Tax Act.
- Foreign venture capital investors (FVCI's) need to be registered with SEBI. They should have the facility of hassle free investments and disinvestments without any requirement for approval from FIPB/RBI.
- Increase the list of institutional investors permitted to invest in venture capital funds to include banks, mutual funds, insurance companies and pension funds up to prudential limits.
- New structures, such as limited partnerships, limited liability partnerships and limited liability corporations should be made eligible for registration as venture capital funds.
- Flexibility should be provided in the matter of investment ceiling and sectoral restrictions:
- Buy back, take over and IPO norms should be liberalized.
- Issue of shares with differential right with regard to voting and dividend should be permitted for VC funds.

- A market for trading in unlisted securities by QIB's to be developed.

Conclusions
There is a very strong nexus between entrepreneurial activities, venture capital and economic growth. Countries/economies which recoded more than average growth rate have witnessed a spur in the entrepreneurial activities as precedence to economic growth.

India is the youngest country in the world with average age of 27. Almost 40% of Indians are younger than 15 years of age. This represents the enormous amount of economic activity that is bound to happen in the country in the next 4-5 decades. Economists predict that India's growth story which started 2 decades ago will continue for another 3-3 ½ decades. This clearly shows the quantum of fortune/potential that India is having to en-cash the same. Making best use of this potential is through developing entrepreneurial activities in the nation. In this regard VCFs play vital role in stimulating and encouraging such entrepreneurship developmental activities.

Bibliography
M.Y.Khan (2011), Financial Services, Sixth Edition, Tata McGraw Hill, New Delhi, ISBN 1-25-900166-0

Prasanna Chandra (2001), Financial Management: Theory and Practice, Fifth Edition, McGraw Hill, New Delhi, ISBN 0-07-044501-X

M.Y.Khan and P.K.Jain (2011), Financial Management: Text, Problems and Cases, Sixth Edition, Tata McGraw Hill, New Delhi, ISBN 0-07-106785-X

Chandrasekhar, K.B. (2000), Report of K.B. Chandrasekhar Committee on Venture Capital, Delhi: Securities and Investment Board of India.

www.ventureintelligence.in

www.sebi.gov.in

Sara Publishing Academy
Indian Journal Of Applied Research
Journal for All Subjects

Editor,
Indian Journal Of Applied Research
8-A, Banans, Opp. SLU Girls College,
New Congres Bhavan, Paldi, Ahmedabad-380006.
Contact.: +91-9824097643 E-mail : editor@ijar.in

Printed at Unique Offset, Novatsing Rupam Estate, Opp. Abhay Estate, Tavdipura, Shahibaug, Ahmedabad