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Management

Venture Capital in India: A Study of Time Gap of Investments

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ABSTRACT Venture Capital has come to occupy an important place in the financial world by meeting the financial gaps for undertakings that are unable to raise finance from the traditional sources of financing. There has been an unprecedented surge in the Venture Capital investment deals in recent years in India on account of the growing entrepreneurial culture and increase in supply of finance by the Venture Capital Funds. The underlying study attempts to explore the Venture Capital investments by studying the Venture Capital investment deals for more than 12 years. The study attempts to find the time gap that elapses between the year in which the VC undertaking is incorporated and the year in which first VC investment takes place.

KEYWORDS : Venture Capital, Venture Capital Fund, Investment

Introduction

Venture capital industry is globally understood as "independently managed, dedicated pools of capital that focus on equity or equity-linked investments in privately held, high-growth companies" (Dossani & Kenney, 2002; Gompers & Lerner, Spring 2001).

Venture Capital (VC) is an investment by Venture Capital Funds, out of the funds received from the wealthy individuals and institutional investors, in the form of shares or a later stock option in potentially high-risk businesses. The beneficiary companies are usually small or medium-sized firms, requiring seed or early-stage funding for innovation and development of technology or products, with high growth potential. High annual returns ranging from 25-75% are expected on such investments. Venture capital is a long-term investment and involves active participation and help from the investor for the development of the company. Often, the presence of the VC investor/s gives the company commercial and financial clout (Kaushik, 2014).

A flourishing venture capital industry in India can fill the gap between the capital requirements of manufacturing and service based start-up enterprises and funding available from traditional institutional lenders such as banks. The gap exists because such start-ups are necessarily based on intangible assets such as human capital and on a technology-enabled mission, often with the hope of changing the world (Haritha, V, & Reddy, 2012).

In India, the Venture Capital Industry was governed by Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996. Also the Foreign Venture Capital investors are governed by SEBI (Foreign Venture Capital Investors) Regulations, 2000. Recently in an attempt to provide a comprehensive regulation framework for private pools of capital Securities and Exchange Board of India (SEBI) notified Alternative Investment Funds Regulations, 2012 on May 21, 2012 as a result of which SEBI (Venture Capital Funds) Regulations, 1996 were repealed.

Objective

The objective of the paper is to understand the basic investment trends in the VC industry and to ascertain the elapsed time gap between the year of incorporation and the first infusion of investment in Venture Capital Undertaking (VCU) by the VCFs.

Literature Review

According to Lerner (2008) the three broad areas of research in the field of venture capital have been fund raising, investing and exiting. Research in the area of investing focuses on the ties between venture capitalists (VCs) and the firms in which they invest. While investing in new firms, staged financing is found to be the most important means to overcome the agency conflicts between the investors and the entrepreneurs. The venture capitalists try to concentrate investments in early stage companies and high technology industries where information asymmetries are significant and monitoring is valuable. Further the investors prefer to invest with peers to benefit from a second opinion to avoid bad deals.

Gompers (1995) uses agency theory to predict the factors that affect the duration and size of investment. According to him expected agency costs increase as assets become less tangible, growth options increase, and asset specificity rises. Decreases in industry ratios of tangible assets to total assets, higher market-to-book ratios, and greater R&D intensities lead to more frequent monitoring. He finds that Venture Capitalists concentrate on investments in the early stage and high technology industry. This is because in early stage investments and high technology industries information asymmetries are vast and monitoring is more valuable. The Venture Capitalists monitors the firm's progress and if any negative information about future returns is predicted then they take a decision to abandon the firm. Early stage firms receive lesser money per round and increase in asset tangibility increase financing duration and reduce monitoring intensity. Further the bigger the role of future investment opportunities in the firm value and higher the R &D intensity the shorter is the duration of the round.

Research Methodology

To explore time gap of Venture Capital investment the methodology adopted is descriptive and quantitative in nature. To undertake the analysis data pertaining to Venture Capital investment deals has been collected for the period spanning January 1, 2004 to October 31, 2016. The deal data for venture capital investments has been collected from Venture Intelligence PE/VC deal database. In data cleaning some deals have been verified from Crunchbase, which is a comprehensive database of the start-up activity.

The time period has been selected keeping into consideration the availability of data, major growth period of the Venture Capital industry and the demonetisation of the high denomination currency in India. The study involves analysis of 2676 venture capital investment deals. These investment deals pertain to first to fourth round of institutional investments into undertakings that are:

1) Less than 10 years old, and
2) Investment amount is less than $20 M

The collected data relates to date of investment, name of VCU and amount of investment. Data for the year in which the Venture Capital Undertaking was founded could be collected for 844 undertakings. Data for the year in which Venture Capital Undertaking was founded shall enable understanding the time gap between the year of incorporation of the VC undertaking and the year in which the first VC investment was made.

Analysis and Results

The data relating to Venture Capital Investments during 2004 to 2016 covers a considerably long period of time to understand trends in the VC industry. Table 1 reveals the trends in the VC investment over the years. It is found that VC investment deals have been increasing considerably over the years and the VC deals increased from 35 in 2004 to 485 in 2015 before dropping to 324 in 2016 (deals only up to

October 2016). However, even when considered on average basis there has been a decline in number of deals in 2016. There has also been an increase in the total amount of VC investment and average amount of VC investment over the years before declining considerably in 2016. This is primarily on account of the change in the approach of VC investors who now have become conservative in their investment approach and await return on their existing investments. The number of deals, total and average amount of investment also declined in 2009 on account of the global financial crisis.

Table 1: Year-Wise Distribution of Venture Capital Deals, Total Amount of Investment (US$M) and Average Amount of Investment (US$M)

Year	Number of Deals	Total Amount of Investment(US$M)	Average Amount of Investment(US$M)
2004	35	132.64	4.57
2005	51	216.17	4.91
2006	129	517.14	4.70
2007	165	655.48	4.93
2008	170	714.86	5.26
2009	117	414.13	3.94
2010	160	656.96	4.53
2011	228	972.82	4.79
2012	248	754.61	3.91
2013	257	766.12	3.48
2014	307	991.54	3.66
2015	485	1784.94	4.17
2016	324	922.79	3.84
Total	**2676**	**9500.20**	**4.21**

Time Gap between Year of Incorporation of VC Undertaking and First Infusion of Venture Capital

It is of great interest to ascertain the time that elapses between the year of incorporation of the VC undertaking and it receiving VC finance for the first time. The average time gap between the incorporation of Venture Capital Undertaking and its first time infusion of funds is found to be 2.60 years (Table 2). However the median time is 2 years and the mode time is 1 year. These descriptive statistics imply the availability of financing in the initial years of the establishment of the Venture Capital Undertaking that is essential to promote entrepren eurship in any country.

Table 2: Time Gap between Year of Incorporation of VC Undertaking and First Infusion of funds

No. of Companies	844
Average Time Gap (in years)	2.60
Median Time Gap (in years)	2
Mode Time Gap (in years)	1

It is found that 23.46% of undertakings received funding after one year of their establishment (Table 3). This is followed by 20.97% of the undertakings that received funding in the year in which they were established. Further the chance of firms receiving venture capital decrease as the firms become older because venture capital funds invest primarily in the initial years of an undertaking. These results are in sync with the literature that Venture Capitalists prefer to make investment in the early stage of the undertaking when information asymmetries are high and monitoring is valuable. Also, since the current data relates to investments of up to $20 million only the deals with the higher investment amount are the private equity deals as per the classification used by the database from which the data has been obtained and therefore has not been considered for the purpose of this study.

Table 3: Distribution of VC Undertakings based on Time Gap (in years) between Year of Incorporation and First Infusion of Funds

Time Gap	Number of VC Undertakings	Percentage	Cumulative Percentage
1	198	23.46%	23.46%
0	177	20.97%	44.43%
2	134	15.88%	60.31%
3	101	11.97%	72.27%
4	66	7.82%	80.09%
5	42	4.98%	85.07%
6	34	4.03%	89.10%
7	31	3.67%	92.77%
8	28	3.32%	96.09%
9	25	2.96%	99.05%
10	8	0.95%	100.00%
Total	**844**	**100.00%**	

Conclusion

Venture Capital industry is a relatively new industry in India in comparison to the western countries like USA and UK. In the recent times the industry has witnessed a surge on account of the growing interest of the country's youth in entrepreneurship. Based on the study of investment deals spread over a period of more than 12 years it has been found that Venture Capitalists in India prefer to invest in the initial years of the VC undertakings and lesser deals are entered into in the later years of the VC undertaking.

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