IJRAR.ORG E-ISSN: 2348-1269, P-ISSN: 2349-5138

INTERNATIONAL JOURNAL OF RESEARCH AND ANALYTICAL REVIEWS (IJRAR) | IJRAR.ORG
An International Open Access, Peer-reviewed, Refereed Journal

VENTURE CAPITAL IN INDIA: TRENDS, GROWTH AND CHALLENGES

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Abstract: As considerable financial innovation, the venture capital industry has emerged in the 20th century. It attracted the mind of academicians and researchers. It is financing technology based flexible form of innovative business. In India, in order to investment size, private investing can be categorized as - venture capital and private equity. Venture capitalists are defined as investors investing in start-ups and early stage growth companies whereas investors investing in late stage growth are known as private equity. The objective of the paper is to study the existing scenario and recent trend of venture capital in India with its trend growth and challenges ahead.

Key Words: Venture Capital, Innovative Business, Entrepreneurship, Start-up

INTRODUCTION

As one of the rapid growing economies in the world, India has been attracting investor attention during last 2 decades. India's has young population of 1.3 billion and a diversified economy has driven capital formation and consumption. India has witnessed 8% GDP growth between 2008–18 and with the structural reforms like Goods and Sales Tax, Insolvency and Bankruptcy Code, higher financial inclusion and digitization etc., it is estimated that the economy will reach USD 4.7 trillion by 2024

It is wide way of getting finances to invest in business which hold a bright future in terms of profit and growth as well. The Venture Capital phenomenon in India is quite young compared to other countries where it has been about for several decades. The term venture capital is a combination of two words i.e. "Venture and Capital". It is financing technology based flexible form of innovative business.

Venture Capital made with two words, Venture and Capital. "Venture" is a processing way to the uncertain outcome but to which is attended the "risk". Whereas word "Capital" uses as recourses to business. Venture capital has no universal definition and it has different meanings for different people. No single definition is able to define the venture capital. According to SEBI Venture Capital Funds (VCFs) Regulations, 1996, "A Venture Capital Fund means a fund established in the form of a trust/company; including a body corporate, and registered with SEBI which has a dedicated pool of capital raised in a manner specified in the regulations and invests in venture capital undertakings (VCUs) in accordance with these regulations."[1]

OBJECTIVES

- To study the existing scenario and trend and growth of venture Capital in India
- To find out the challenges of Venture Capital in Indian financial system

KEY ELEMENTS FOR VENTURE CAPITALISTS

Basically, there are lots of elements which are studied by venture capitalists about financing ventures like management, potential of capital gain, realistic financial requirements and projections and owner's financial stake etc. 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. The potency, knowledge & harmony of the member on key position on the board bring considerable credibility to the firm. The members should be experienced, having working knowledge and capable of taking potentially high risks.

The required rate of return is about 30-40% by venture capitalists, so potentiality of capital gain should be measured with the average rate of return. The venture capitalist need a reasonable outlook about the organization's health and future projections related to nature and performance of the firm like scale of operations, operating profit, costs related to product Research & Development.

[1] www.sebi.gov.in

STAGES OF GROWTH OF A FIRM UNDER VC FUNDING

The Venture Capital funding varies across the different stages of growth of a firm. These are as follows:

First Stage (Pre Seed Stage): It is initial stage where a comparatively small amount of capital is provided to conceive and convert a potential idea in to reality which has good future prospects. **Second Stage (Seed Stage):** It is a stage of product development. In this stage finance is provided to product development. Besides it, finance is also provided to begin preliminary marketing formalities.

Third Stage (Early Stage): It is called first stage of matured VC. In this stage, finance is provided to firm to start commercial manufacturing and sales.

Fourth Stage: In this stage, finance provided for working capital for the extension of the firm. In this stage, finance is provided also for growing accounts receivable and inventory.

Fifth Stage: In this stage, funds provided to the firm for major expansion and increasing sales volume. This stage is met when the firm crosses the breakeven point.

Sixth Stage (Bridge / Mezzanine financing or Later Stage financing): In this stage, finance is provided to a company before its Initial Public Offer. Besides it, bridge finance is planned. Bridge finance is helpful to be repaid, from the proceeds of a public offering.

VENTURE CAPITAL: INDIAN PERSPECTIVE

Conceptual Framework

In India, according to investment size, private investing can be categorized as - venture capital and private equity. Venture capitalists are defined as investors investing in start-ups and early stage growth companies whereas investors investing in late stage growth are known as private equity.

According to (India Private Equity Report 2011), India's Venture capital industry is not reaching its full potential because of lack in the regulatory support. Indian policymakers do not consider Venture capital as a different asset nor do they give adequate attention on regulatory environment for more helpful to industry growth.

There are many reasons for low capital flows towards venture capital in India, like, low base of domestic Limited Partners (LPs), changing and shifting regulatory and tax structures, not fully understanding the VC asset class, early experiences is not at par with global experience, lack of promoting activities for innovation, enterprise and scientific technology and knowledge-based ideas etc.

Historical Perspective and Trend

Since nineties era, venture capital in India was known. Now, it has successfully emerged for all the business firms. Business firms, who take up risky projects with high growth prospects, are adopting venture capital process. Venture Capital in India is provided as risk capital in the forms of shares, seed capital and other similar means. In India, venture capital industry started in 1964. In 1988, ICICI emerge as a venture capital provider with unit trust of India.

In 1988, Technology Development and Information Company of India Ltd. (TDICI), a joint venture of ICICI and UTI, was the first organization in India to commence venture capital operations. TDICI was the investment manager and the funds were registered as UTI's Venture Capital Unit Scheme (VECAUS).[2]

The government is promoting growth in capacity utilization of available and acquired resources. Only 08 domestic venture capital funds were registered with SEBI during 1996-1998, 14 funds have already been registered in 1999-2000. Institutional interest is growing and foreign venture investments are also increased.[3]

For the IT sector, many state governments have also set up venture capital funds with the SFIs and SIDBI partnership, Apart from Indian investors, international companies too have settled in India as a financial institute providing investments to large business firms. With international competition, there have been a number of growth oriented business firms that have invested in venture capital.

It is because of foreign investors that financial markets have developed in India on a large scale. Introduction of western financial philosophies, tight contracts, focus on profitable projects and active involvement in finance was contributed by foreign investors only.

On the of Chandrasekhar committee's recommendation, SEBI defined the regulatory framework of the VC industry through its SEBI (Venture Capital Fund) Regulations, 1996 and SEBI (Foreign Venture Capital Investor) Regulations, 2000. India has grown a lot, earlier there were only commercial banks and a few financial institutions but now there are lot of opportunities with venture capital investment institutes. Now business can get financial support with venture capital so they thing about expansion plans.

The scale and quality of the business enterprises have increased in India now. All the business firms can opt for venture capital investment in India whether they deal in information technology, manufacturing products or/and providing contemporary services.

Phases of Growth The growth of the VC industry in India has followed a sequence of distinct phases:-

Phase – 1 (Pre 1986): The VC industry was in its infancy and adoption of the asset class was done by the central government and government-sponsored institutions only.

Phase – 2 (1986 – 1995): There were a few activities experienced within the venture capital scenario, but it was still restricted to government-sponsored institutions.[4]

Phase – 3 (1995 – 1999): Private venture capitalists started taking interest in the Indian investment opportunities. It was the result of successful Indian entrepreneurs in Silicon Valley. In 1993, the Indian Venture Capital Association (IVCA) was established. In 1999, approximately 80% of total venture capital investments were derived from overseas firms, with 21 VC firms registered and 8 of them from the public sector.

Phase – 4 (2000 – 2010): VC funds started testing Indian waters with economic liberalization showing some early positive results and Indian firms becoming more successful in Silicon Valley.[5]

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[3] https://www.sebi.gov.in/sebi_data/commondocs/aug-2017/Venture%20Doc_p.doc

[4] https://www.bfp.vc/venture-capital-in-india-landscape-overview-part-2

[5] ibid

Phase – 5 (2011 – 2014): This phase saw aggressive VC competition due to an increasing number of deals. LPs view on India's macro-economic fundamentals was strong.

Phase – 6 (2016 onwards): As early VC entrants such as Sequoia, SAIF, and Accel evolved, VCs focused on effecting select and larger deals and this trend is reflected in the broader market. 80% of VC funds were invested in four sectors, with the most investment going to consumer tech, followed by fintech, B2B commerce and tech, and Software/SaaS.[6]

CHALLENGES AHEAD

VC is in its nascent stages in India. The global competitiveness has put an immense pressure on the industrial sector to improve the quality level with product cost minimization by applying latest technological skills. In India, the financing firms expect a sound, experienced, mature and capable management team of the company being financed.

But the innovative project involves a higher risk with the expectation of higher returns. So there are a lot of challenges in the way of successful venture capital funding in India. An experienced management team is required and an initial stage it is not available. Uncertainty regarding the success of the product in the market is also a barrier.

There are lot of questions/arrangement regarding the infrastructure details of production like plant location, accessibility, relationship with the suppliers and creditors, transportation facilities, labour availability etc. should be answered/finalized, which is very tough task. Besides this, the category of potential customers and hence the packaging and pricing details of the product is also a part of a long and process which required adequate skills and experiences. Other challenges are the size of the market, major competitors and their market share and regulatory restrictions etc.

CONCLUSION

In India, there is a huge scope for VC. The govt. should promote innovative ideas of business and provide basic training to transform such ideas in to real business. In which process, regulatory and financial support is required. A right direction is required for VC industry and it may be very helpful for the economic heath and growth of India.

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