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A Study on Venture Capital a catalyst for start up

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***Abstract:** In addition to angel investing, equity crowd funding and other seed funding options, venture capital is attractive for new companies with limited operating history that are too small to raise capital in the public markets and have not reached the point where they are able to secure a bank loan or complete a debt offering. In exchange for the high risk that venture capitalists assume by investing in smaller and early-staged companies, venture capitalists usually get significant control over company decisions, in addition to a significant portion of the companies' ownership (and consequently company value). Startups like Uber, Airbnb, Flipkart, ReviewAdda, Xiaomi & Didi Chuxing are highly valued startups, where venture capitalists contribute more than financing to these early-stage firms; they also often provide strategic advice to the firm's executives on its business models and marketing strategies. This paper explores the concept of venture capital funding, its stages and its growth in India. This paper focus on how the venture capital drives the economy for start up.*

***Keywords:** venture capital, seed funding, equity crowd funding, start up.*

I. INTRODUCTION

Venture capital is a type of private equity, a form of financing that is provided by the firms or funds to small, early-stage, emerging firms that are deemed to have high growth potential, or which have demonstrated high growth. Venture capital firms or funds invest in these early-stage companies in exchange for equity-an ownership stake-in the companies they invest in. venture capitalists take on the risk of financing risky starts-ups in the hopes that some of the firms they support will become successful. The start-ups are usually based on an innovative technology or business model and they are usually from the high technology industries, such as information technology (IT), social media or biotechnology. The typical venture capital investment occurs after an initial "seed funding" round. The first round of institutional venture capital to fund growth is called the series A round. Venture capitalists provide the financing in the interest of generating a return through an eventual "exit" event, such as the company selling shares to the public for the first time in an initial public offering (IPO) or doing a merger & acquisition (also known as trade sale) of the company. Venture capital is also a way in which the private and public sectors can construct an institution that systematically creates business networks for the new firms and industries, so that they can progress and develop. This institution helps identify promising new firms and provide them with finance, technical expertise, mentoring, marketing "know-how", and business models. Once integrated into the business network, these firms are more likely to succeed, as they become "nodes" in the search networks in designing and building products in their domain. However, venture capitalists' decisions are often biased, exhibiting for instance overconfidence and illusion of control like entrepreneurial decisions in general.

II. VENTURE CAPITAL FUNDING

Obtaining venture capital is substantially different from raising debt or a loan. Lenders have a legal right to interest on a loan and repayment of the capital irrespective of the success or failure of a business. Venture capital is invested in exchange for an equity stake in the business. The return of the venture capitalist shareholder depends on the growth and profitability of the business. This return is generally earned when the venture capitalist "exits" by its shareholdings when the business is sold to another owner.

Venture capitalist are typically selective in deciding what to invest in; as a result firms are looking for the extremely rare yet sought after qualities such as innovative technology, potential for rapid growth, a well developed business model and an impressive management team. Of these qualities, funds are most interested in ventures with exceptionally high growth potential, as only such opportunities are likely capable to providing financial return and a successful exit within the required time frame (typically 3-7 years) that venture capitalists expect. Because investments are illiquid and require the extended time frame to harvest, venture capitalists are expected to carry out detailed due diligence prior to investment. Venture capitalists also are expected to nurture the companies in which they invest, in order to increase the likelihood of reaching an IPO stage when valuations are favourable. Venture capitalists typically assist at four stages in the company's development:

- idea generation;
- Start up;
- Expansion;
- Exit;

Because there are no public exchanges listing their securities, private companies meet venture capital firms and other private equity investor in several ways, including warm referrals from the investors' trusted sources and other business contacts; investor conferences and symposia; and summits where companies pitch directly to investor groups in face- to- face meetings, including a variant known as "speed venturing", which is akin to speed- dating for capital, where the investor decides within 10 minutes whether he wants a follow- up meeting. In addition, some new private online networks are emerging to provide additional opportunities for meeting investors.

This need for high returns makes venture funding as an expensive source for companies and most suitable businesses having large up-front capital requirements, which cannot be financed by cheaper alternatives such as debt. That is most commonly the case for intangible assets such as software and other intellectual property, whose value is unproven. In turn, this explains why venture capital is most prevalent in fast growing technology and life sciences or biotechnology fields.

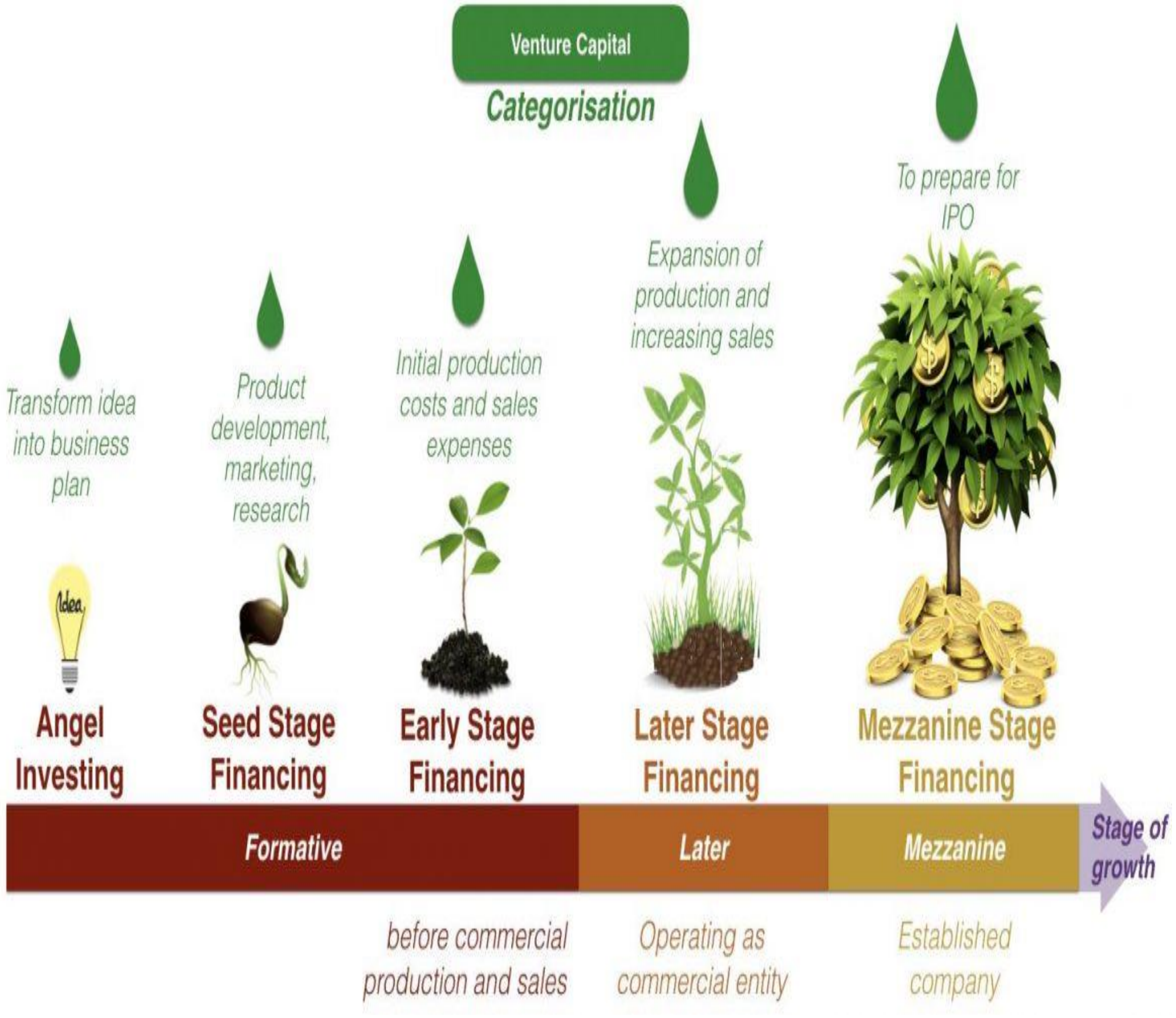
If company does have the qualities venture capitalists seek including solid business plan, a good management team, investment and passion from the founders, a good potential to exit the investment before the end of their cycle, and target minimum returns in excess of 40% per year, it will find it easier to raise venture capital.

III. Financing Stage

There are typically six stages of venture round financing offered in venture capital that are as followed:

1. **Seed funding:-** The earliest round of financing needed to prove a new idea, often provided by angel investors. Equity crowd funding is also emerging an option for seed funding.
2. **Start-up:-** early stage firms that needed funding for expenses associated with marketing and product development
3. **Early stage:-**Financing is provided to companies that have expanded their initial capital and now require funds to initiate commercial-scale manufacturing and sales.
4. **Growth and expansion funding (2 stage):-** Working capital is provided for the expansion of accompany which is producing and shipping products and which needs to support growing accounts receivable and inventories. Although the company clearly has made progress, it may not yet be showing a profit at this stage.

5. **Further expansion stage(3 stage):-** Funds are provided for a major expansion of a company funds are utilized for further expansion like for plant expansion ,diversification or for development of improved product, new technology or n expended product line.
6. **Mezzaanine/ bridge financing/pre-public stage:-** After reaching this juncture, the company may looking to go public, given that its products and services have found suitable traction. Funds received here can be used for activities such as:
    - Merger& acquisition
    - Price reduction/ other measures to drive out competitors
    - Financing the step toward an IPO



If all going well, investors may sell their shares and their engagement with the company, having made a healthy return. Many tech –IPO like think Facebook, Twitter and Yelp- were possible after years of VC funding that fueled user and revenue growth. There's a saying that there's no free lunch, and VC funding of free apps & services is a good case in point.

IV. OBJECTIVES OF THE STUDY

There are the following objectives of my study

- To study the concept of venture capital funding

- To study stages of venture capital finance
- To study Growth of venture capital in India
- To study venture capital helps to drive startup economy

V. How Venture Capital Helps Drive the Startup Economy

Companies usually begin with little more than a dream: a concept, an idea, or an invention. But while hope, inspiration, and some personal savings can be the promising seed for a startup' it often takes much more grow a concept into a thriving company. Long before a startup company can borrow large amount of money by going in public, alternative sources of funding are needed. And that's where angle investors and venture capital investments come into play. One hundred years ago, most venture capital came from just a few wealthy families like the Rockefellers. Today, investors who wish to participate in VC investments often do so through managed venture capital funds. Professional angel investors typically participate in angel groups or angel investor networks. Below is an overview of how important venture capital is to startups in the U.S., based on data from the National venture capital Association (NVCA)- and what you need to know if you're hoping to raise it for your business someday.

VI. Helping Little Companies Become Big

Venture capitalists have a large impact upon the world of commerce. Venture capitalists invest more than $ 22 billion into approximately 2,700 United States companies every year, according to the NVCA.

Approximately 2.7% of that money is invested in seed stage companies. But the bulk of venture capitalist funds are invested in companies that have progressed beyond the seed stage, but haven't matured to the point of being able to go public.

On average, the capital invested varies based upon the stage of growth of the company, as follows:

- Seed stage companies (7% of VC deals):Average VC funding of $2,645,379.20
- Early stage companies(44%% of VC deals):$4,781,354.58
- Expansion stage companies(26%of VC deals):$9,805,542.89

Later stage companies (22% of VC deals):$10,354341.33

VII. Where and How Venture Capitalists Invest Most?

Venture capitalists can be found in just about every state in the nation. But top five states in terms of average VC funding are:

- California
- Maassacheusetts
- New York
- Washington
- Texas

California is at the front of the pack, generating more than $14 billion in VC funding each year- more than 4 times that of the next closest state in VC funding, Massachusetts. And venture capitalists help to fund companies across a broad spectrum of industries. But more than half of all venture capitalist funding is invested across just four industries:

1. Software – 31.2%of venture capitalist funding
2. Biotechnology – 15.6%
3. Industrial/ Energy-10.4%
4. Medical devices and Equipment- 9.2%

Though the flat economy has had an impact on the amount of venture capitalist funding available in recent years, the industries of retailing and software have experienced increases in VC funding.

VIII. Growth of Venture Capital in India

Venture capital in India was known since nineties era. It is now that it has successfully emerged for all the business firms that take up risky projects and have high growth prospects as well. Venture capital in India is provided as risk capital in the forms of shares, seed capital and other similar means.

In 1988, ICICI emerge as a venture capital provider with unit trust of India. Financial banks like ICICI have stepped into this and have their own capital subsidiaries. Apart from Indian investors, international companies too have settled in India as a financial institute providing investments to large business firms. It is because of foreign investors that financial market 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.

The financial investment process has evolved a lot with time in India. Earlier there were only commercial banks and some financial institutes, India has grown a lot.

Startup companies need a certain amount of investment for growth. Wealthy investors like to invest their capital in businesses with long-term growth in view. This capital is known as venture capital and the investors are called venture capitalists. The venture capital investment is made when a venture capitalist buys shares of companies and becomes a financial partner of their business.

The data recorded at the end of Q3 2019 states that the **top 10 most active Venture Capital firms in India** alone contribute to **32%** of the total deal count in the startup ecosystem. The Venture Capital investment is often termed as risk capital or patient capital. This is because most VC investing capitals or rather a majority of them harbor tremendous risks of parting from the money invested if the venture doesn't succeed. Besides, the capital coming from the venture capital firms or the VC funds usually need a medium to long term period for the investments to fructify.

The Indian startups secured over **$12.1 billion** from the venture capital funds in the first 6 months of 2021, which is $1 billion more than the overall funding that they received last year. Venture Capital (VC) investment in India more than doubled from its previous quarterly high of $6.7 billion in Q2 2021 to **$14.4 billion during Q3 2021**, according to a recent report by KPMG.

In the year 2021, the Indian startups have successfully managed to mop up $36 bn worth of funds and most of them came from the VC funding for startups and private equity investments, which increased by 3X from the earlier year. These funds are not only helping the startups find it easier to raise funds but are also adding gear to the Indian startup ecosystem, thereby making it a prominent and growing entity in the global landscape.

Therefore, raising funds from venture capitalists is the way to go for the Indian startups of now.

Top VC Firms in India -

1. Sequoia Capital
2. Accel

3. Blume Ventures
4. Elevation Capital
5. Tiger Global Management
6. Kalaari Capital
7. Matrix Partners
8. Nexus Venture Partners
9. Indian Angel Network
10. Omidyar Network India

IX. Venture Capital Firms in India

Venture capital firms in India can be divided into four categories

1. All India –Developmental Financial Institutions – The following are the major financial institutions providing venture capital on all India basis.
    a) Industrial Development Bank of India (IDBI) - The formation of venture capital fund of IDBI begins in 1986. In the venture financing scheme, it considers all those projects whose financial need extends from Rs. 5 lakhs to Rs. 205 crores. It is also successful in introducing technological innovations, reduction in material consumption, energy consumption, cost, etc.
    b) Industrial Finance Corporation of India (IFCI) – Industrial Finance Corporation of India is the oldest concern in venture capital business. In 1975, the corporation patronized Risk Capital Foundation, which was later converted into a company on January, 1988, to provide risk capital to first generation entrepreneurs for establishment of industrial projects.
    c) Industrial Credit and Investment Corporation of India (ICICI) – The ICICI established Technology Development and Information Co. of India (TDICI) in January, 1988 and started its operation in July, 1988 to finance the new and established entrepreneurs for the development of indigenous technology. The function of this company relates to supply of data relating to technology and to giving advice and to support technology and technology-management and to supply administrative service regarding Programme for Advancement and Commercial Technology and Programme for Acceleration of Commercial Energy Research. TDICI has also introduced Venture Capital Units Scheme (VECAUS II) for providing financial assistance to the ventures.
2. State-level Developmental Financial Institutions - In supply of venture capital the remarkable financial institution in state level is Gujrat Venture Finance limited, promoted by Gujrat Industrial Investment Corporation, being established in the year 1990 to provide venture financing to the new and existing companies along with technological innovations to reduce cost and increase profit. Besides this, in the state-level of Andhra Pradesh, the Andhra Pradesh Venture Capital Ltd. is established by Andhra Pradesh State Industries Corporation to supply venture capital in the state.
3. Venture Capital Fund created by Commercial Banks – Different commercial banks have introduced different programmes for providing venture capital. Among them three banks are remarkable – State Bank, Canara Bank and Grindlays Bank. The State Bank of India launched Capital Market Funds which is used to invest in equity share of a new and unknown ventures.

    Canara Bank of India launched its Venture Capital Fund in August, 1989 to provide finance to ventures which have technological innovations and high-tech technology and high return to the funds. ANZ Grindlays Bank launched a Venture Capital Fund to provide facilities to non-resident Indians to enjoy the benefits of getting funds from them in selective investment for new-technology based ventures.

4. Private Sector Venture Capital Funds – In our country some venture capital funds have been established in private sectors. Credit Capital Venture Fund (CCVF) was established in January, 1990 to provide venture finance and invest in the primary market. Indus Venture Capital Fund (IVCF) was established in 1991 as a private venture capital financier to invest in the equity of the ventures. The Twentieth Century Finance Company (TCFC) was established in 1992 to provide venture capital. Infra-structural Leasing and Financial Services Limited (ILFSL) has also been providing venture capital.

FUTURE PROSPECT OF VENTURE FINANCING IN INDIA :

In a developing country like India, venture capital is much prospective and plays the developmental role. The unification of managerial and marketing expertise with the riskful finance makes venture capital an effective tool to transfer enterprise development and technology in developing countries. In India the presence of the following factors are essential for venture capital to succeed.

1. The presence of creativity, innovation and initiative on the part of the entrepreneur along with inspiration from the society and the government.
2. An economic environment with the opportunity for creation of high technology and quality goods.
3. The existence of a liquid share market to meet the demands of the small and medium entrepreneurs.
4. Creation of confidence among the investors to invest in equity.
5. Introduction of a venture-trend system of education where the scientists and engineers have knowledge about accounting, economics, finance and the accountant also acquire knowledge in physical science and engineering.
6. To increase venture capital proper marketing, promotion, implementation of new ideas, etc. are needed.
7. To ensure technological upgradation, adequate amount of research and development project should be inspired by the government, public and private sector companies.
8. Effective management education and training programmes are needed to develop professionals who can properly manage venture capital

X. CONCLUSION

Business forms focus on expansion because they can get financial support with venture capital. The scale and qualities of the business enterprises have increased in india now. With international competition, there have been a number of growth oriented business firms that have invested in ve(Paul, 2015)nture capital. All firms that deal in information technology, manufacturing products as well as providing contemporary services can opt for venture capital investment in India.

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