VENTURE CAPITAL FINANCING IN INDIA: A STUDY OF CURRENT TRENDS AND CHALLENGES

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ABSTRACT

All financial institution generally required the collateral securities for the purpose of loan security. Here, entrepreneur can avail for the venture capital. It is the risk capital provided to the firms or project having high growth potentials. In this research paper researcher examine the genesis of venture capital financing and issues and challenges faced by venture capital companies. It is found that VC investors were very much interested to invest in the IT/ITES sector. In India, VC investors are risk-oriented and they are contented to finance or to encourage innovative and new ideas whether to invest in the business which established themselves and earned higher yield.

KEYWORDS

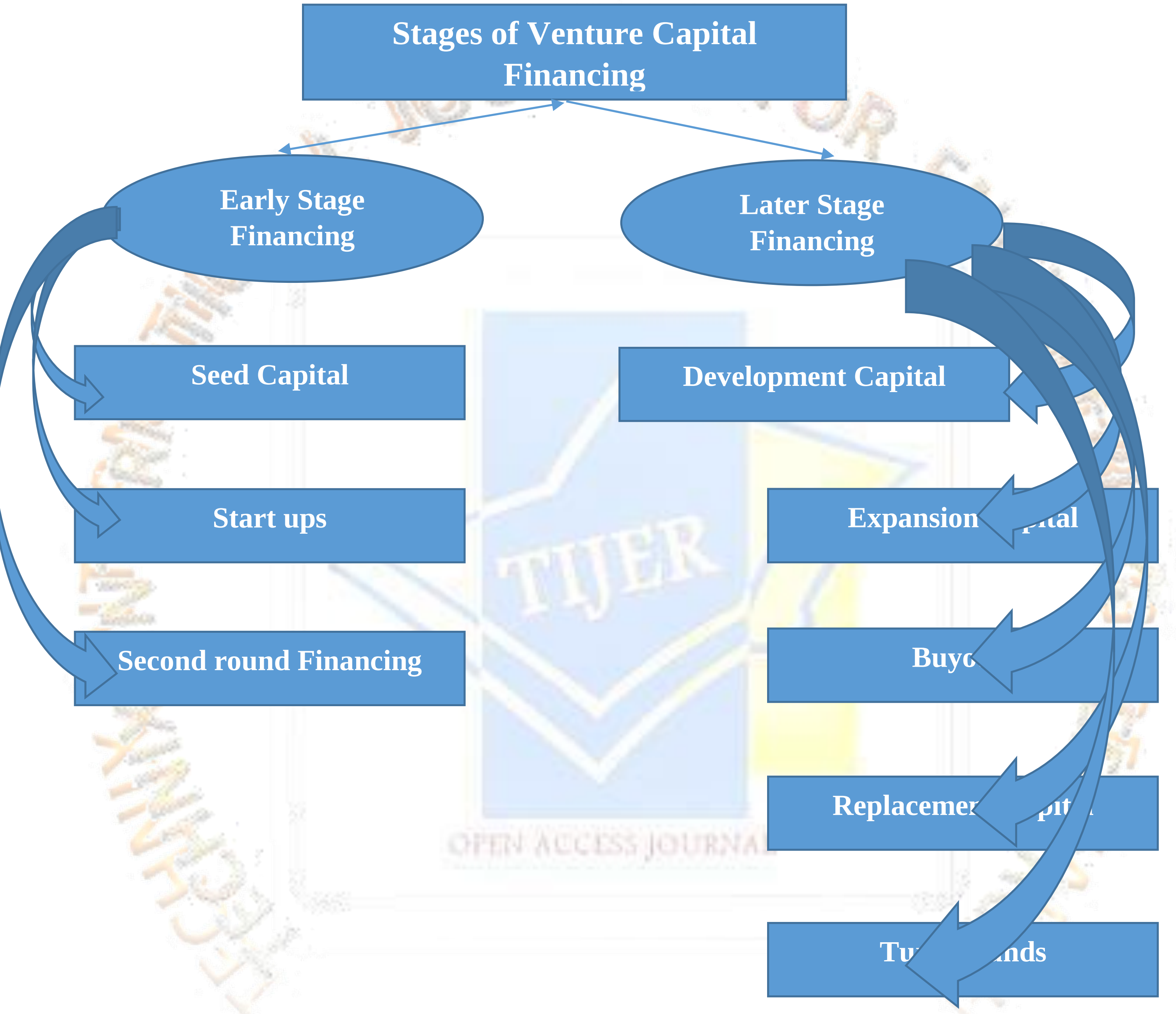
Early Stage, ITs, Seed Capital, Private Equity, IVCA

INTRODUCTION

India having a large youth population across the world, so there are infinite number of innovative ideas to start the small and medium enterprises. But converting the imagination into the reality is not so easy because of India's economy. Getting loan, expertise, experience, skills etc.' at the right time is very difficult. All financial institution generally required the collateral securities for the purpose of loan security. Here, entrepreneur can avail for the venture capital. It is the risk capital provided to the firms or project having high growth potentials. It is the small to medium term financing alternative provided to start-up companies which are capable for sustain the growth for the long period of time with their unique feature and discrete business ideal. There are terms exists i.e. venture and capital. Venture means a new firm introduced in market having growth potentials and capital is blood of any business activities without which one cannot imagine about existence. It is the money requirement of the business. In venture capital financing small investors invest their savings in the various funds, they are called limited partners. The person who collects the saving of limited partners are known as venture capitalists and in which fund investment made is known as venture capital funds. By investing these funds by the venture capitalists in various innovative ideas term as venture capital financing. Venture capitalists gets equity in the concerned start-ups and after its maturity period they sold out the venture and collects huge amount.

Venture capital is not the new term for the world yet it is well known by the developed countries since many years. In India also venture capital has remarked prosperous growth and opportunities. Every sector whether it is ITs, telecom, commerce, banking, manufacturing and business venture capital spread its strong roots and makes an incredible changes in the concerned sectors. Even in the agriculture also, the trend pattern of venture capital is increasing year by year.

Venture capital mainly provided in two stages i.e. early stage and later stage. Below diagram enumerates the stages of venture capital financing clearly:



At early stage venture capital evaluates the technology viability, potential market and capabilities of the promoter to implement the project. Further at later stage venture capitalists examines the new markets, track record of business and track record of entrepreneur. Venture capitalist have to make decision whether they want to invest in early stage or in later stage.

LITERATURE REVIEW

- **Kumar Vinay A and Kaura N Mohinder (2003)** in their research paper, **"Venture Capitalist Screening Criteria"** study the four factors which are used by the venture capitalist to screen new venture proposals. The study brings out the strong association between the several variables pairs i.e. successful ventures put in sustained efforts on identified target markets.

- **Davila Antonio and Foster George and Gupta Mahendra (2003)**, in their research paper entitled, **"Venture Capital Financing and The Growth of Startup Firms"** examines the association between the presence of venture capital (VC) and the employee growth of startups. Changes in the number of employees over successive rounds of financing documents the relationship between growth in startup financial valuation and changes in the number of employees over successive rounds of financing.

- **HSU H. David (2004)** in his paper entitled **"What Do Entrepreneurs Pay for Venture Capital Affiliation?"** Enumerated the authentication and value-added roles of well-earned venture capitalists. The author analyzed the financing offer made by the reputed venture capitalists are most likely to be accepted at a 10-14% discount as startup equity. The study concluded that venture capitalist earned extra-financial value which is significantly higher and differ from their actual functional financial capital.

- **Smolarski Jan, Verick Hira, Foxen Sarah and Cankut (2005)** in their paper entitled **"Risk Management in Indian Venture and Private Equity Firms: A Comparative Study"** study the various magnitude of risk associated with the Indian VCPE industry investing in small and big sized enterprises in comparison to U.K. funds. The study found that the syndication method has been broadly used in India as well as the U.K. and the stage financing method was used very partially to reduce the risk factor and retrench hostile selection of projects. The study concluded that portfolio risk management technique is underdeveloped in both the countries due to lack of proper and definite investment and portfolio theory which can elaborate the method of converting illiquid assets into liquid assets quickly.

Engel Dirk and Keilbach Max (2006) in their paper entitled **"Firm-Level Implication of Early Stage Venture Capital Investment: An Empirical Investigation"** explored the efficacy of venture capital finance on the growth and innovation of newly-established firms in Germany. With the help of statistical tools study found that a larger number of venture capital firms are patented applications. However, venture capitalists prefer to invest in such projects which are having an innovative output. The study concluded that if venture capitalists are curious about the commercialization of proposed projects growth rate will significantly higher than patent venture capital investment. The success of any venture capitalist depends upon the systematic and thorough selection process of proposed projects.

OBJECTIVES OF THE STUDY

1. To study the current scenario of venture capital financing in India.
2. To trace out the issues and challenges faced by the Venture capital companies.

RESEARCH METHODOLOGY

Types of Study

The study is descriptive in nature.

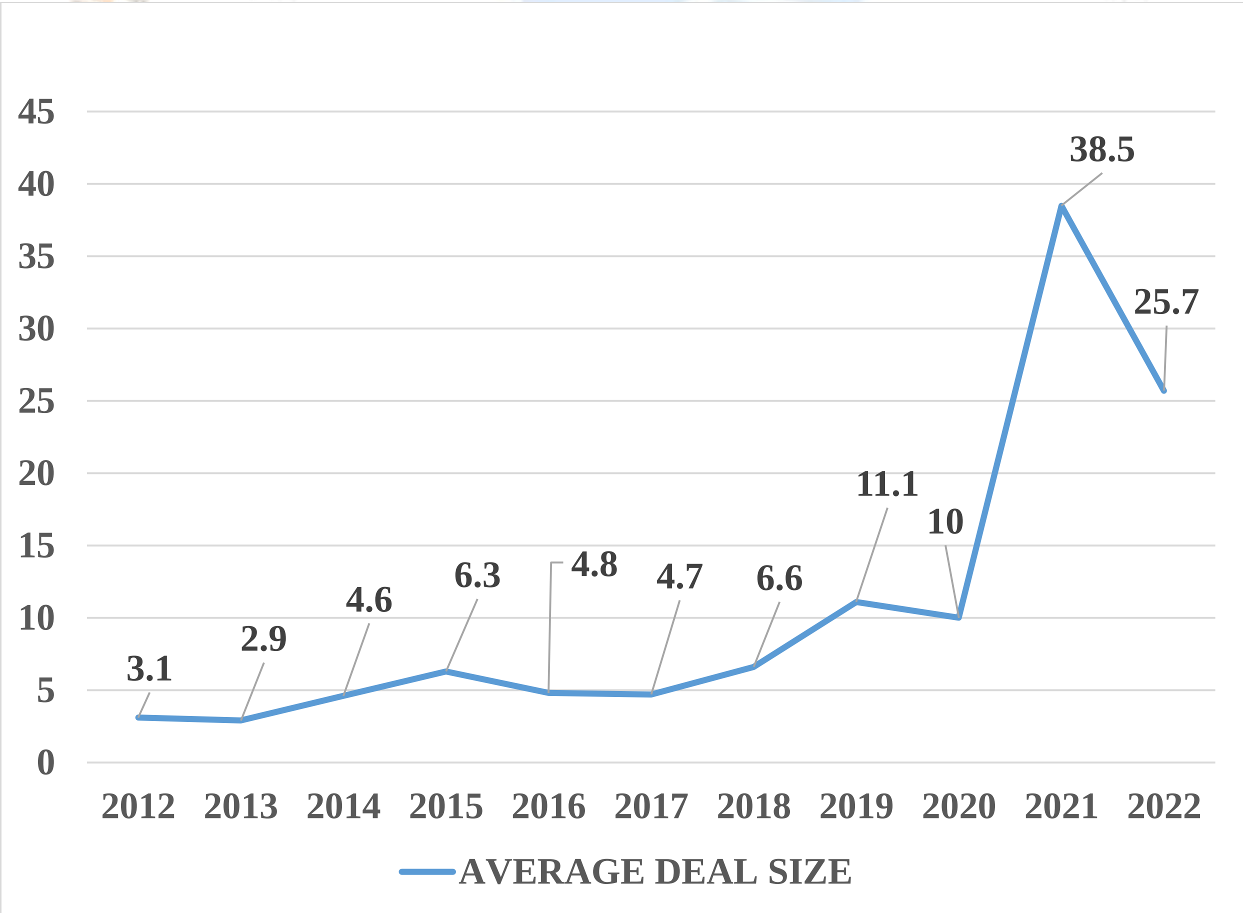
Data Types

The present study is based on the secondary data.

Sources of Data Collection

Primarily data has been collected from SEBI websites and IVCA websites. Various journals, newspapers, articles, research papers, websites has been used to collect the concerned data.

ANNUAL VC INVESTMENTS IN INDIA ($β)



RESULTS AND ITS IMPLICATIONS

ICICI bank was the pioneer of venture capital industry in India with collaboration with Unit Trust of India in the year 1988. From that period of time to present, Venture capital has gone through various ups and down but accelerate a healthy sources of finance. ICICI in association with unit trust of India formed a venture capital subsidiary technology development and Information Company of India (TDICI) for financing technology oriented innovative companies. In the year 2009, 95 funds were invested in a total of 151 Indian VC companies with the amount of US $ 570 million which is approx. The US $ 3.8 million invested in per company. From 2010 to 2015 there was recorded continuous growth in the number of VC companies as well as registered consistent growth in the number of VC funds. But the amount invested by the funds were fluctuate very sharply. An increase in the number of VC companies and the number of funds does not lead to an increase in the number of the investment amount. From 2010 to 2015 lowest investment was US $ 807 million in 2010 and the highest investment was US $ 1219 million in the year 2015. The average investment also fluctuated accordingly. In the year 2016 number of VC companies decreased to 575 and the amount invested by funds were also decreased to US $ 1855 million only whereas the number of funds increased to 301. During the years 2018 and 2019 number of VC companies, the number of funds, the amount invested by funds and the average investment were started increasing. But it was discontinued in the year 2020 and the number of VC companies, the number of funds and amount investment decreased to 514, 294 and the US $ 1798 million and the average investment of companies also decreased. 2022 was a year of recalibration as VC funding momentum slowed down globally and in India. India investments saw a 33% compression from $38.5 billion to $25.7 billion over 2021–2022.

Caution in investing momentum globally was driven by broader macroeconomic uncertainty and recessionary fears—tightening of monetary policies by central banks after an extended rate moratorium and Covid-19 stimulus led capital influx, geopolitical uncertainty disrupting food and energy supply chains, growing inflation across economies, trade sanctions by US and Europe exacerbating the supply-demand rift, and surfacing of corporate governance issues across VC funded companies. While these headwinds had an influence on funding in India, the broader economic outlook remained relatively resilient and continued to be supported by a few structural drivers:

- ❖ **Large consumption opportunity:** Sizeable middle class with large working-age population, services-driven economy, expanding manufacturing base.
- ❖ **Inclusive economic growth led by scale adoption of digital rails:** For example, UPI for payments, ONDC for e-commerce, electronic health records further enabled by cheap access to data creating a material digital enabled population base.
- ❖ **Fiscal and monetary discipline:** Judicious fiscal stimulus during the pandemic, efficient commodity sourcing given global price volatility keeping inflation in check.
- ❖ **"China + 1" tailwinds:** Incentives boosting manufacturing and tailwinds from global supply chain diversification leading to new economic avenues.

Issues and challenges faced by Venture Capital financing:

There are certain pertinent issues of venture capital financing in India which synonymously are the issues of private equity as well are as follows:

- **Product risk:** the product risk concerned with little and no track records in the market as they have high rate of obsolescence.
- **Entrepreneur risk:** another issue related to the venture capital financing is that it is very difficult to assess information of new management and new established business without prior trace record.
- **Concentration risk:** Concentrating on small market which may be based either on product bases or on geographical basis, raises risk for sectorial downturn
- **Technology risk:** It is very difficult to assess new technology for small set of products.
- **Duration risk:** there is longer payback period for funding is needed
- **Asset risk:** there is high percentage of obsolete fixed assets, along with high fraction of man power, there is lack of collateralized assets, which is one of the issue concerned with venture capital financing.

Apart from above issues there are some challenges which have to be faced by venture capitalist as obtaining private equity or venture capital is of challenging in nature. Firstly, the private equity investor may replicate the business idea that he was presented with and pass it on to another established company where he holds ownership stakes. Secondly, Private equity investors may use the company to further the cause of other companies where they have larger investments.

CONCLUSION

Venture capital is a form of funding to start-up companies and entrepreneurs. It can be provided at different stages of the evolution of companies. In India, it seems to be venture capital fundraising activity yet to be fully realized. Therefore the venture capital fundraising activity has recorded not much satisfactory growth during the period of study. It is quite clear from the analysis of the overall growth of venture capital financing in India that there is an incredible rising trend excepting the few years. It is found that VC investors were very much interested to invest in the IT/ITES sector. In India, VC investors are risk-oriented and they are contented to finance or to encourage innovative and new ideas whether to invest in the business which established themselves and earned higher yield.

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