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Examination of venture capitalists role in Indian Economy

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Abstract

In India venture capitalists lead an important role in supporting newly set-up companies and establishing perspective industries. Venture capital is a growing business in a recent era in the area of industrial financing in India. Venture capital financing is that pool of money which is provided by wealthy angels. According to SEBI regulations venture capital funds means "a fund established in the form of the company or any trust which raises money through different sources of finance and invest into ventures in accordance with these regulations. This paper examines the specifities and consequent challenges of emerging economies for incoming venture capitalists through discussion of number, types and stages of opportunities for investment and possibilities of exiting options from the investment.

Keywords: Venture Capital, venture capitalist, Challenges, Emerging economies.

Introduction

Prior to engaging in a discussion of the role of venture capitalist in Indian economy, it is very important to shed some light on the definition of venture capital. American literature understands it to be a investment by specialized venture capital funds in high growth, high risk, high technology firms that need capital to finance growth (Black & Gilson, 1998).The term "Venture

Capital" is understood in many ways. In a narrow sense it refers to investment in newly set-up companies that are lacking funds for growth. In a broader sense, venture capital refers to the commitment of capital as shareholding for the formulation and setting up of new firms with new ideas or new technologies. Start –up business often need external financing to grow. Venture capital is money provided by professionals who invest and manage young rapidly growing companies that have the potential to develop into significant economic contributors. In the Indian context, the concept of venture capital may be defined as investment in the form of equity, quasi-equity or conditional loan, invest in new unlisted high risky firms. Venture capital and private equity financing are becoming popular routes of foreign investment into India. Depending upon the stage at which funding is required; venture funds can be classified into various types like angel investors, venture capitalist, private equity players etc.

Venture capital firms and funds

A venture capitalist is a person or investment firm that makes investments in newly set-up ventures. These venture capitalists are expected to bring managerial and technical expertise as well as capital to their investments. A venture capital fund refers to a pooled investment vehicle which is also known as limited partners or Limited Liability Company. Limited Liability company primarily invests the financial capital of third-party investor in enterprises that are too risky for the standard capital markets or bank loans.

Venture Capitalist's in Emerging Economy

For venture capital to progress in an economy, the concept of industrialist must become a part of the societal framework (Bygrave, 1989). Venture capitalists are opportunity seekers (Bygrave, 2001). Abundance and visibility of entrepreneurial activity are necessary to attract their attention (Guler and Gullien, 2004). This is particularly the case for venture capital firms engaging in cross border activities, whose primary motivation and objectives are achieving high return on investment (ROI) figures (White, Gao, and Zhang, 2002). Therefore it is necessary to examine the number of opportunities offered to VC's, but even more importantly, the nature or type of the opportunities at hand.

The Venture Capital industry has grown many folds over the last decade and a half. The number of venture capital funds increased in a significant manner the total corpus increased from Rs.200 crores in 1990 to Rs.5000 crores in 2000 and approximately 15,000 crore in 2010.

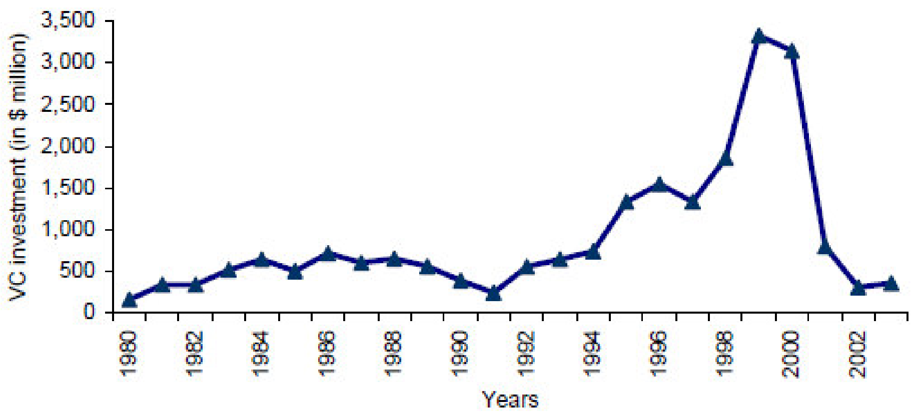
In India the venture capital plays a vital role in the development and growth of innovative entrepreneurs. Venture capital financing is in its early stage in India. The emerging scenario of global competitiveness has put an immense pressure on the industrial sector to improve the quality level with minimization of cost of products by making use of latest technology skills. Venture capital may take various forms at different stages of the project. There are four successive stages of development of a project like development of a project idea, implementation of the idea, commercial production and marketing and finally large scale investment to exploit the economics of scale and achieve stability. Cumming and Macintosh have defined venture capital as "Financial intermediaries who gets capital investment from various institutional investors, high net worth people from the various economic sectors and make investment of these pooled deposits in small and private business which have high technology and have a lot of potential for high growth.

In general term we can say that venture capital means capital which is intended to invest into a highly risky firm with good growth potential. Venture capitalist is a person who works as an intermediary between investors who give their fund to invest and new companies which gets risk capital on another hand.

Venture capital investment process

This is the process by which a venture capital company invests into a venture. The initial point is how it raises the fund from the different sources. There is a five step approach developed by Tybee, Bruno and Isakson. Starting at the very beginning, there are six early stages in the investment financing of a firm: seed, startup, expansion, mezzanine, buyout, and (if needed) turnaround. Most venture outlays focus on the seed, startup, and expansion stages.

A tiny fraction of venture capital money, about two per cent, goes in earliest-stage financing, called seed money, which constitutes funds for initial research to prove a concept. A significant proportion of venture capital is invested to support product development and initial marketing (often referred to as startup funds). In figure 1.2 the investment disbursement of startup and seed activities has been shown:



Source: Thomson Venture Economics/National Venture Capital Association

It is very clear form the above figure that from 1980-02, startup/seed activities constituted $21.4 billion out of the total US$ 339.9 billion invested in all the business stages, accounting for approximately 6.3 per cent of all US venture capital disbursements. Startup/seed activities rose from $157.5 million in 1980 to a first peak of $1.5 billion in 1986, a nearly ten fold increase. They then fell to $241 million in 1991, for an 83.9 per cent decline. Seed/early money then ramped up to a peak of $3.3 billion in 1999, leading the high-tech (and medical) boom and other sectors as well. The latest reduction was also vivid: a 90 per cent decline from 1999 to a low of $352 million in 2002. It remained approximately the same last year, at $354 million.

This early set may be driven by funds availability and optimism or pessimism. However, it also may reflect how many promising ideas have been generated at that point by ongoing innovation and the advance of knowledge. The early seed cycle will also partly drive the later cycles.

There are seven stages where venture capital companies may invest-their fund into various venture starting from seed to turnaround from the above data it is clear indication that there is no definite pattern to invest into ventures. But we can see from the table number 1 that venture capital firms have invested more in seed startup, first and turnaround stage.

Table 1

Classification of venture capital companies by investment into stages

Stage	Seed	Start-up	First	Second	Expansion	Mature	Turnaround	Total
Number of venture capital companies	8	5	6	3	2	2	4	30
Per cent of VC Firms	26.66	16.66	20	10	6.66	6.66	13.33	100

Source: Primary Data

We can see secondary, maturity and turnaround stages are very less as compare to other stages. Seed stage is 26 per cent which shows good sign of investment. Start-up is 16.66 per cent which shows good sign of improvement. Further we see that there is an increase in first stage which shows that there is a good improvement in this stage.

After that second stage has shown decline and it is just ten per cent, again we can see decline in expansion and maturity stage and at last turnaround stage shows an increase to 13.33 per cent.

From the above results we can easily see that there is no definite pattern of investment of various venture capital companies in India. But these companies are working very fine in India and they are contributing a lot for the development of Indian economy. We can see in the last decade these companies have given an impetus for growth of Indian economy. We analyse this growth from the India's GDP and SENSEX. Even when other countries are not faring well and their economies were faltering. Indian economy is showing good sign government of India have introduced new foreign policy for economic development and opened new sector and increased FDI limit in various sector. Now venture capital firms from other nations can take advantage of this situation.

Investment by the venture capital companies into various sectors in India

In table number 2 the various sectors have been shown where venture capital firms have invested. The data of thirty companies have been taken and this is the data for three years 2010 to 2012 respectively.

Table 2

Investment by the venture capital companies into various sectors in India

Fund invested	Number of cases in	Per cent investment	Number of cases	Per cent investment	Number of cases	Per cent investment

	total firms 2010		in total firms 2011		in total firms 2012	
IT companies	80	26.66	120	20.00	220	22.00
Logistics	30	6.66	60	10.00	80	8.00
Consumer durables	30	10	40	6.66	100	10.00
Media	20	6.66	30	5.00	50	5.00
Biotech	10	3.33	15	2.5	70	7.00
Agriculture	15	5	5	0.08	30	3.00
Mining	30	10	40	6.66	80	8.00
Education	10	3.33	15	2.5	20	2.00
Petrochemical	30	10	50	8.33	50	5.00
Constructions	20	6.66	55	9.16	60	6.00
Manufacturing	10	3.33	34	5.66	40	4.00
Telecom	5	1.66	64	10.66	55	5.5
Pharma	5	1.66	23	3.83	15	1.5
Entertainment	4	1.13	20	3.83	30	3.00
Hotels	6	2	15	2.5	35	3.5
Wellness	4	1.13	5	0.08	35	3.5
Others	1	0.33	9	1.5	30	3.0
Total	300	100	600	100	1000	100
H index	0.1815		0.0709		0.0621	

Source: Primary Data

In 2010 we have taken 300 cases. In 2011 we have taken 600 cases and in 2012 we have taken 1000 cases. In 2010 the most preferred sector was IT sector followed by logistics, consumer durables and media. Petrochemical was one of the areas where investment is also considerable. Construction has attracted in 20 cases which is also a good sign of success but other areas such as manufacturing, telecom, pharma, entertainment did not attract venture capital fund fairly.

In year 2011, we have collected data of 30 companies and total cases were 600 here again. IT companies have attracted most cases followed by logistics, telecom, construction and consumer durables.

There is a good growth of number of companies' cases into various investment patterns.

In year 2012, we have collected data of 30 companies and total cases were 1000. Here one thing is important to consider that for the same companies number of cases of investment is increasing year by year.

This shows a healthy sign of development of Indian economy. In 2012, IT companies again attracted most of the cases followed by consumer durables 100, biotech 70 and logistics 80 and mining 80 cases. Here we see that other sectors have also increased and number of cases have increased in 2012 as well. H index is 0.1815 in year 2010, which shows diversification of the companies and in year 2011, it is 0.0709 which shows further diversification and in year 2012, it is 0.0621 which shows more intense diversification pattern.

Conclusion

The venture capital industry is emerging in India as a result of internal and external factors. The World Bank funded the creation of the first venture capital funds. These funds were the beginning of a process of legitimatizing venture investing and they were a training ground for venture capitalists who later established private venture capital funds.

The world is becoming increasingly competitive. Companies are required to be more efficient in relation to cost, productivity, labour efficiency, technical know-how skills, adaptability and foresightedness.

There are many sectors of the economy that are ready for venture capital investors like IT, Retailing, Manufacturing, Pharmacy, and many more.

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