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CRITICAL STUDY OF ENTREPRENEURSHIP AND VENTURE CAPITAL

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ABSTRACT

Entrepreneurship is the act of being an entrepreneur, which can be defined as "one who undertakes innovations, finance and business acumen in an effort to transform innovations into economic goods". This may result in new organizations or may be part of revitalizing mature organizations in response to a perceived opportunity. The most obvious form of entrepreneurship is that of starting new businesses (referred as Startup Company); According to Paul Reynolds, entrepreneurship scholar and creator of the Global Entrepreneurship Monitor, "by the time they reach their retirement years, half of all working men in the United States probably have a period of self-employment of one or more years; one in four may have engaged in self-employment for six or more years. Participating in a new business creation is a common activity among U.S. workers over the course of their careers." And in recent years has been documented by scholars such as David Audretsch to be a major driver of economic growth in both the United States and Western Europe.There are various financial steps in going for start ups.These steps are challenging and an entrepreneur may face constraints. This study reflects those constraints and the possible means of solution in the present scenario for venture capital.

Key words: Start Up,Economic growth,Constraints,Business acumen

1.INTRODUCTION

Entrepreneurial activities are substantially different depending on the type of organization and creativity involved. Entrepreneurship ranges in scale from solo projects (even involving the entrepreneur only part-time) to major undertakings creating many job opportunities. Many "high value" entrepreneurial ventures seek venture capital or angel funding (seed money) in order to raise capital to build the business. Angel investors generally seek annualized returns of 20-30% and more, as well as extensive involvement in the business. Many kinds of organizations now exist to support would-be entrepreneurs including specialized government agencies, business incubators, science parks, and some NGOs. In more recent times, the term entrepreneurship has been extended to include elements not related necessarily to business formation activity such as conceptualizations of entrepreneurship as a specific mindset (see also entrepreneurial mindset) resulting in entrepreneurial initiatives e.g. in the form of social entrepreneurship, political entrepreneurship, or knowledge entrepreneurship have emerged.

You can start a business on paper, but it takes funding to make it an operational reality. Unfortunately, many good ideas never get off the ground because of a lack of seed money. And, many of those outfits that do get up and running become extinct early due to running out of financial resources. One way to prevent either of these scenarios is to secure corporate venture capital. This kind of investment, which can infuse sizable amounts of money into your business, does not come without serious risks. Consider these risks carefully before deciding to pursue this money.

2.LITERATURE REVIEW

The entrepreneur is a factor in microeconomics, and the study of entrepreneurship reaches back to the work of Richard Cantillon and Adam Smith in the late 17th and early 18th centuries, but was largely ignored theoretically until the late 19th and early 20th centuries and empirically until a profound resurgence in business and economics in the last 40 years. Donald Trump is one such example.

In the 20th century, the understanding of entrepreneurship owes much to the work of economist Joseph Schumpeter in the 1930s and other Austrian economists such as Carl Menger, Ludwig von Mises and Friedrich von Hayek. In Schumpeter, an entrepreneur is a person who is willing and able to convert a new idea or invention into a successful innovation. Entrepreneurship employs what Schumpeter called "the gale of creative destruction" to replace in whole or in part inferior innovations across markets and industries, simultaneously creating new products including new business models. In this way, creative destruction is largely responsible for the dynamism of industries and long-run economic growth. The supposition that entrepreneurship leads to economic growth is an interpretation of the residual in endogenous growth theory and as such is hotly debated in academic economics. An alternate description posited by Israel Kirzner suggests that the majority of innovations may be much more incremental improvements such as the replacement of paper with plastic in the construction of a drinking straw.

For Schumpeter, entrepreneurship resulted in new industries but also in new combinations of currently existing inputs. Schumpeter's initial example of this was the combination of a steam engine and then current wagon making technologies to produce the horseless carriage. In this case the innovation, the car, was transformational but did not require the development of a new technology, merely the application of existing technologies in a novel manner. It did not immediately replace the horsedrawn carriage, but in time, incremental improvements which reduced the cost and improved the technology led to the complete practical replacement of beast drawn vehicles in modern transportation. Despite Schumpeter's early 20th-century contributions, traditional microeconomic theory did not formally consider the entrepreneur in its theoretical frameworks (instead assuming that resources would find each other through a price system). In this treatment the entrepreneur was an implied but unspecified actor, but it is consistent with the concept of the entrepreneur being the agent of x-efficiency.

The behavior of the entrepreneur reflects a kind of person willing to put his or her career and financial security on the line and take risks in the name of an idea, spending much time as well as capital on an uncertain venture. Knight classified three types of uncertainty.

Risk, which is measurable statistically (such as the probability of drawing a red color ball from a jar containing 5 red balls and 5 white balls).

Ambiguity, which is hard to measure statistically (such as the probability of drawing a red ball from a jar containing 5 red balls but with an unknown number of white balls).

True Uncertainty or Knightian Uncertainty, which is impossible to estimate or predict statistically (such as the probability of drawing a red ball from a jar whose number of red balls is unknown as well as the number of other colored balls)

It has assumed super importance for accelerating economic growth both in developed and developing countries. It promotes capital formation and creates wealth in country. It is hope and dreams of millions of individuals around the world. It reduces unemployment and poverty and its a pathway to prosper. Entrepreneurship is the process of searching out opportunities in the market place and arranging resources required to exploit these opportunities for long term gains. It is the process of planning, organizing, opportunities and assuming. Thus it is a risk of business enterprise. It may be distinguished as ability to take risk independently to make utmost earnings in the market. It is a creative and innovative skill and adapting response to environment of what is real.

VENTURE CAPITAL AND UNDERPRICING: CAPACITY CONSTRAINTS AND EARLY SALES -ROBERTO PINHEIRO (February 7, 2012

Finally,based on a database of 3,050 US IPOs from 1987 to 2007, I show that the distribution of some Örm characteristics at the IPO of VC-backed issuing Örms in hot issue markets has fatter tails than itscounterpart for cold markets. Based on the model, this result is derived by the optimal reaction of VC Örms to changes in the market tightness of VC market

Venture Capital Financing : A Theoretical Model Mondher Cherif ,Sana Elouaer (ISG – Sousse)

We find that up-front funding can provide greater benefits than in case of staged funding. Moreover, under given conditions, we find that staged funding acts as a successful device in controlling information asymmetries. At a second stage, we find that syndicated investments used with active monitoring gives the higher profit to the start-up due to the VCs free-riding problem in monitoring.

Mirjam van Praag Roetersstraat 11-1018 WB Amsterdam9JEL Code: G3, J2, L2.)A novel method is applied to evaluate the effect of capital constraints on entrepreneurial performance on a panel of 1,000 Dutch entrepreneurs. We find that initial capital constraints hinder entrepreneurs in their performance, even when we control for various human capital-and other factors that might affect both performance and credit scoring outcomes. We use a direct individual indicator variable for initial capital constraints. Previous research with the same objective used indirect indicators of wealth, inheritances or windfall gains, where it remains unknown whether the entrepreneur indeed suffered from capital constraints. This drawback is not attached to our (neither perfect) approach so that policy implications will become more evident.

RESEARCH METHODOLOGY

This study is based on both primary and secondary data. Information collected from authentic websites and Govt. of India data.

3.DATA ANALYSIS AND INTERPRETATION

3.1New Venture Feasibility Analysis

The first step in creating a business plan is to outline your concept, begin to define the scope of your business, and to visit each of the principal parts of your prospective plan:

1 Company Overview

2. Product/Service Description
3. Industry and Marketplace Analysis 4. Marketing Strategy

4. Distribution and Sales Strategy 6. Operations Plan 7. Development Plan

5. Financial Estimates

1. Company Overview

The Company Overview is a brief description of the company you have founded or want to found. How will it be organized? Will it be a sole proprietorship, partnership, or corporation? What are your ambitions for the company? Will it always be a small company, or do you want to grow it into an international giant? Upon reading this section, the reader should have a good idea of where you are and where you are going with your company.

What is the name of our company? Does it company currently exist, or will it be forming?

How is our company organized (e.g., sole proprietorship, partnership, corporation…)?

What is our overall strategy and what objectives do we have? What are our goals for the company (keep it small, grow it big, franchise it…) What is the exit strategy for ourselves and for our investors (sell to larger company, go public, buy out investors…)

What additional information do we need to describe and organize our company?

2. Product/Service Description

The Product and Services section is a detailed description of the products and/or services you will be selling. You should not assume that the reader is familiar with your product/service, so be sure to explain and describe it carefully.

What exactly is our product or service? What isn't it? Carefully describe.

What is unique about our product/service? What are its features and benefits? Do we have any proprietary rights to the product/service (for example, technology, patents, copyrights, etc.)?

Why is our product/service superior to the competition, and how is it different?

What additional information do we need to define our product or service?

3. Industry and Marketplace Analysis

The Industry and Marketplace Analysis section dispassionately describes and outlines the industry and the marketplace in which you will compete. When finished with this section, you and your readers should understand the dynamics, problems, and opportunities driving your industry and marketplace.

What is the industry that addresses this market? What trends are important in this industry? How does this industry segment the market?

What is the market we intend to serve? How large is it? What is its growth potential?

What motivates customer purchase decisions?

What additional information do we need about our marketplace?

4. Marketing Strategy

The Marketing Strategy section of your plan will make or break the prospects for your venture. In the Marketing Strategy section, show how you are going to fit into your marketplace. What are unmet needs in the marketplace and how are you going to fill them? How will you differentiate your product or service from your competitors? What unique features, benefits, or capabilities will you bring to the marketplace? Who are your customers?

Who are our target customers? What problems are we solving for them? What are their profiles? What motivates their buying decisions?

What are the strengths of our product/service? Weaknesses? Who are our competitors? How will we differentiate our product or service?

How will our product be priced? What are gross revenues per unit sold? What are anticipated annual sales?

What additional information do we need to create an effective marketing strategy

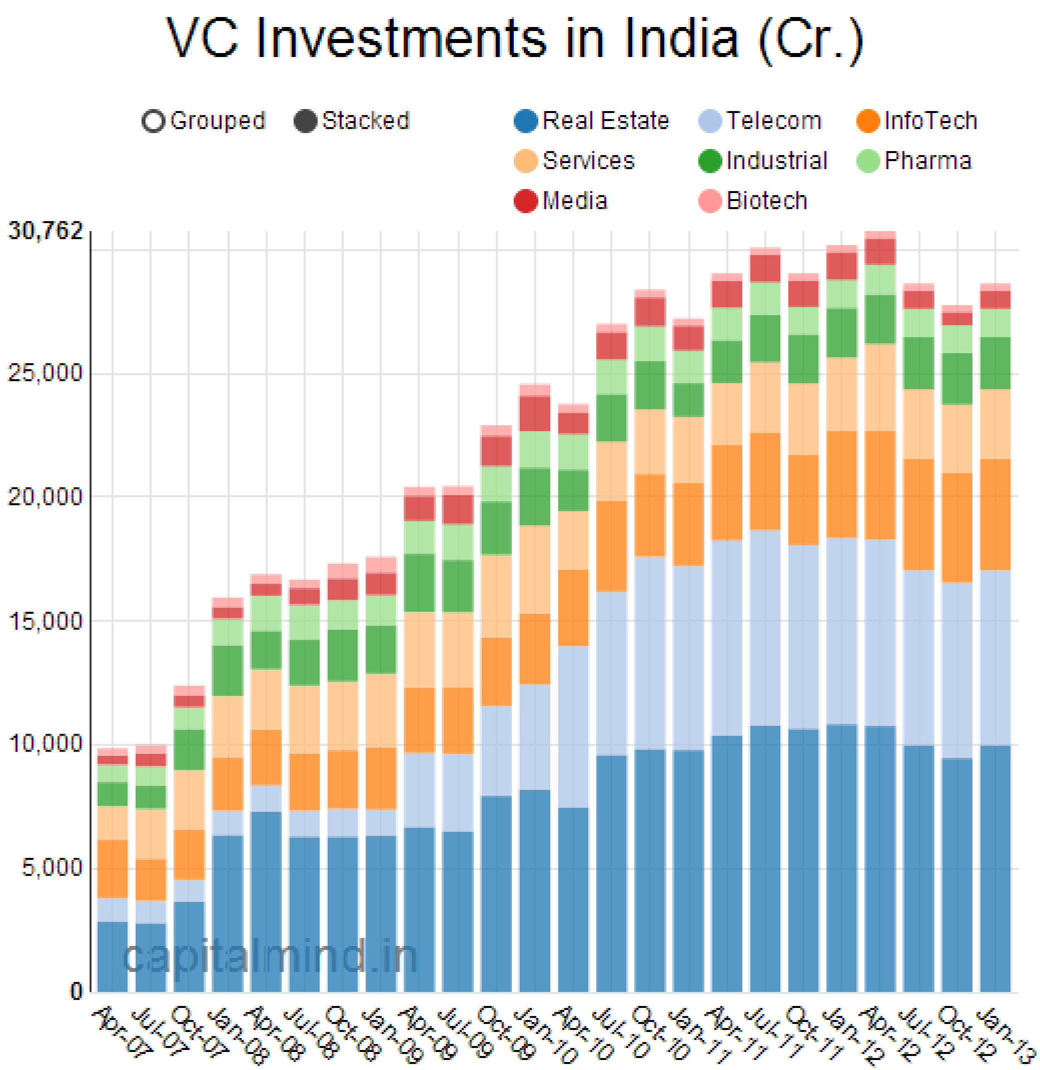

Chart courtesy the nvD3 library.

5. Distribution & Sales Strategy

How will you reach your customers? How will you close the sale with your customers? Remember, "nothing happens until the sale is made."

What distribution channels will we use (e.g., direct sales, mail-order, wholesalers, etc.)?

How will we communicate with our customers (e.g., advertising, promotions, etc.)? How will our product or service be sold? Who will do the selling (our own sales people, manufacturing representatives, etc.)?

What are the costs associated with our sales strategy? Which costs are fixed? Which are variable?

What additional information do we need to create an effective sales strategy?

6. Operations Plan

The Operations section outlines how you will run your business and deliver value to your customers. Operations is defined as the processes used to deliver your products and services to the marketplace and can include manufacturing, transportation, logistics, travel, printing, consulting, after-sales service, and so on. In all likelihood, about 80% of your expenses will be for operations, 80% of your employees will be working in operations, and 80% of your time will be spent worrying about operating problems and opportunities.

Which operations are critical to the success of our business? Which are secondary?

How will we produce and deliver our product/service? What will we do in-house, and what will we purchase (make vs. buy)?

What will it cost to produce and deliver our product or service? Estimate fixed costs (plant, equipment, etc.) and variable costs (labor, materials, etc.)

What additional information do we need understand and cost our operations?

Looking at Venture Capital in the last few years you would think the biggest investment in India would have been in Infotech, or in services (like Flipkart) or even in telecom.

But strangely, the biggest investment as a percentage has been **Real Estate.**

Since 2007, Venture Capital Investments in Real Estate have beaten others by a large margin, and as of December 2012 were nearly at Rs. 10,000 cr. (about 30% higher than the next sector - Telecom)

7- Development Plan

The Development section is a road map of how you are going to get from where you are now to where you want to be in the future. These steps can be as routine as securing retail space, or as critical as applying for and getting a patent on key technology.

What must be done before we can introduce our product or service to the marketplace? What are the risks?

How long will it take to bring our product or service to market? What is our timeline?

What are the one-time start-up and development costs of our business (equipment, deposits, fixtures, furniture, …)?

What additional information do we need understand and cost the development of our product or service?

8- Financial Plan

Our Financial Plan should be frosting on a cake. We have outlined a great business concept, demonstrated a real need in the marketplace, shown how we will execute our ideas, and now will show how much money everyone is going to make

Venture Capital

Starting and growing a business always require capital. There are a number of alternative methods to fund growth. These include the owner or proprietor's own capital, arranging debt finance, or seeking an equity partner, as is the case with private equity and venture capital.

Private equity is a broad term that refers to any type of non-public ownership equity securities that are not listed on a public exchange. Private equity encompasses both early stage (venture capital) and later stage (buy-out, expansion) investing. In the broadest sense, it can also include mezzanine, fund of funds and secondary investing.

Venture capital is a means of equity financing for rapidly-growing private companies. Finance may be required for the start-up, development/expansion or purchase of a company. Venture Capital firms invest funds on a professional basis, often focusing on a limited sector of specialization (eg. IT, infrastructure, health/life sciences, clean technology, etc.).

The goal of venture capital is to build companies so that the shares become liquid and provide a rate of return to the investors that is consistent with the level of risk taken.

With venture capital financing, the venture capitalist acquires an agreed proportion of the equity of the company in return for the funding. Equity finance offers the significant advantage of having no interest charges. It is "patient" capital that seeks a return through long-term capital gain rather than immediate and regular interest payments, as in the case of debt financing. Given the nature of equity financing, venture capital investors are therefore exposed to the risk of the company failing. As a result the venture capitalist must look to invest in companies which have the ability to grow very successfully and provide higher than average returns to compensate for the risk.

When venture capitalists invest in a business they typically require a seat on the company's board of directors. They tend to take a minority share in the company and usually do not take day-to-day control. Rather, professional venture capitalists act as mentors and aim to provide support and advice on a range of management.

Venture Capital Investment Process

Deal origination:

In generating a deal flow, the VC investor creates a pipeline of deals or investment opportunities that he would consider for investing in. Deal may originate in various ways. referral system, active search system, and intermediaries. Referral system is an important source of deals. Deals may be referred to VCFs by their parent organisaions, trade partners, industry associations, friends etc. Another deal flow is active search through networks, trade fairs, conferences, seminars, foreign visits etc. Intermediaries is used by venture capitalists in developed countries like USA, is certain intermediaries who match VCFs and the potential entrepreneurs.

Screening:

VCFs, before going for an in-depth analysis, carry out initial screening of all projects on the basis of some broad criteria. For example, the screening process may limit projects to areas in which the venture capitalist is familiar in terms of technology, or product, or market scope. The size of investment, geographical location and stage of financing could also be used as the broad screening criteria.

Due Diligence:

Due diligence is the industry jargon for all the activities that are associated with evaluating an investment proposal. The venture capitalists evaluate the quality of entrepreneur before appraising the characteristics of the product, market or technology. Most venture capitalists ask for a business plan to make an assessment of the possible risk and return on the venture. Business plan contains detailed information about the proposed venture. The evaluation of ventures by VCFs in India includes;

Preliminary evaluation: The applicant required to provide a brief profile of the proposed venture to establish prima facie eligibility.

Detailed evaluation: Once the preliminary evaluation is over, the proposal is evaluated in greater detail. VCFs in India expect the entrepreneur to have:- Integrity, long-term vision, urge to grow, managerial skills, commercial orientation.

VCFs in India also make the risk analysis of the proposed projects which includes: Product risk, Market risk, Technological risk and Entrepreneurial risk. The final decision is taken in terms of the expected risk-return trade-off .

Deal Structuring:

In this process, the venture capitalist and the venture company negotiate the terms of the deals, that is, the amount, form and price of the investment. This process is termed as deal structuring. The agreement also include the venture capitalist's right to control the venture company and to change its management if needed, buyback arrangements, acquisition, making initial public offerings (IPOs), etc. Earned out arrangements specify the entrepreneur's equity share and the objectives to be achieved.

Post Investment Activities:

Once the deal has been structured and agreement finalized, the venture capitalist generally assumes the role of a partner and collaborator. He also gets involved in shaping of the direction of the venture. The degree of the venture capitalist's involvement depends on his policy. It may not, however, be desirable for a venture capitalist to get involved in the day-to-day operation of the venture. If a financial or managerial crisis occurs, the venture capitalist may intervene, and even install a new management team.

Exit:

Venture capitalists generally want to cash-out their gains in five to ten years after the initial investment. They play a positive role in directing the company towards particular exit routes. A venture may exit in one of the following ways:

1.Initial Public Offerings (IPOs)

2.Acquisition by another company.

3.Purchase of the venture capitalist's shares by the promoter, or

4. Purchase of the venture capitalist's share by an outsider.

FINDINGS AND CONCLUSION

Conflict of Business Interests

Obviously, the corporation is larger and more influential than your startup. Since you need them more than they need you, a conflict of interest could arise in favor of the money source. Primarily, the corporate venture capitalist is more concerned about what's in it for them than your noble mission or altruistic vision. Don't be surprised if the financier's interests seem to be overshadowing yours. The deeper the pockets, the more likely that the strings attached to the funding are thick. Venture capital isn't free, and you will have to make trade-offs in order to secure substantial amounts of it.

Slow Deals, Quick Death

Corporate venture capital size is a good thing when it comes to the amount of money you can secure. However, these financiers may tend to agree to do business more slowly than the traditional venture capital firms. This can be problematic in an instant gratification business market where time often equals money.

Cannibalizing Investor Competition

Financial competition with a Goliath-sized investor may dissuade other equally attractive sources of funding from getting involved with you. Corporate venture capital can unwittingly scare away other investors, particularly competitors. This can damage your business's basic development or hinder later sale of it at auction.

Early Terms In Their Favor

CVC terms may be set in stone early in the negotiation process to secure funding. When you just want someone to believe in your idea as much as you do, these terms and conditions may not seem too bad. But what happens when things really get moving and you are in a better position to leverage some of your new-found clout? The inability to set terms in your favor can potentially sound the death knell for your company

It injects long term equity finance which provides a solid capital base for future growth. The venture capitalist is a business partner, sharing both the risks and rewards. Venture capitalists are rewarded by business success and the capital gain. The venture capitalist is able to provide practical advice and assistance to the company based on past experience with other companies which were in similar situations. The venture capitalist also has a network of contacts in many areas that can add value to the company, such as in recruiting key personnel, providing contacts in international markets, introductions to strategic partners, and if needed co-investments with other venture capital firms when additional rounds of financing are required. The venture capitalist may be capable of providing additional rounds of funding should it be required to finance growth.

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