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Growth of Venture Capital Funding in India

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The purpose of this article is to investigate the creation and growth of venture capital investors in India. The venture capital industry has operated in some capacity in India since 1973. It has now actually evolved for all business organizations that engage in risky endeavors and have significant growth potential. Venture capital investments aid the growth of creative entrepreneurship in India. Various private enterprises may have different views on venture capital if they do not want to borrow funds from public coffers. It may be a key source of capital for small firms in the future (SSEs). Venture capital finance is frequently viewed as an early-stage investment in start-up businesses that are eager to grow quickly. Venture capital is a common strategy used by growth-oriented businesses to combat growing international competition. Due to the lack of flexibility and independence and the drawn-out, difficult process, the bulk of investments in venture capital are undertaken by accredited, high-net-worth individuals or other financial institutions. The opportunities and challenges that entrepreneurs face while trying to get venture capital are the main topics of this essay. A significant turning milestone in the growth of the Indian seed funding (VC) business occurred in 2021 when a record $38.5 billion in VC investments were made. India accounted for more than 50% of all private equity and venture capital investments made worldwide in 2021.

Keywords: *venture capital, financing, investments, growth, venture capital industry.*

INTRODUCTION

In the 21st century, India's economy has surfaced to be one of the ones that are growing the quickest. It is one of the most profitable investment options. India has an economic benefit over other developing nations because of its big skilled labor force, money, and information locked up in research labs. A type of funding that connects all resources available is necessary for effective discovery and utilization. Lending institutions, personal debt, equities, bonds, and other financial instruments are some of the methods to access this relationship. However, each has advantages and disadvantages that exclude its usage in certain situations. Not only does a high-growth sector need cutting-edge technology and significant investment, but also the bravery to take enormous risks[1]. The venture capital sector is growing in India. The long and difficult development of India's consolidated venture capital industry has been hampered or even prohibited by the conceptual approach of socialistic economic concepts, which has set resource constraints. Most young business owners find it difficult to raise money for their ventures, particularly those in the technologies and services industries. Financing for new firms is offered by financial firms and state development finance agencies, but only as security money for specific projects.[2]

The majority of entrepreneurs would have to depend on their economic means in addition to that of the lending institutions, family members, and well-wishers. The cash provided by investment firms, who invest in companies or very early, high-growth enterprises with the ability to become highly successful corporations, is referred to as "venture capital." It includes a greater risk and greater profit. Hence, it acts as an essential source of capital for entrepreneurs with creative company ideas. Private equity is the best method of financing for businesses with sizable upfront cash requirements and no other accessible alternatives.

Venture capital investments aid the growth of creative entrepreneurship in India. It has expanded due to the necessity to provide unorthodox, risky finance to startup companies built

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[1] Komala G, 'A Paradigim shift in Indian venture capital industry' (*CORE*, October 2014) <https://core.ac.uk/download/pdf/72802819.pdf> accessed 18 January 2023

[2] Arpan Sheth & Ors, 'India Venture Capital Report' (*Bain & Co*, 2022) <https://www.bain.com/insights/india-venture-capital-report-2022/> accessed 17 January 2023

on entrepreneurial creativity. An expenditure that is in the form of equity, quasi-equity, or direct or conditional loan, Venture capital is invested in start-up companies that are promoted by entrepreneurs with professional or technical know-how. Venture capital implies risk money. It is made up of capital investments, such as debt and equity, which carry a high level of risk and uncertainty. Venture capital might signify various things to different people. Using a single phrase to describe it is exceedingly difficult.

VENTURE CAPITAL FUNDING

One of the most adaptable ways to finance technologically or innovatively oriented businesses is through venture capital investment. It is a more flexible method of obtaining capital for investments in companies with promising prospects for growth and profit. Instead of being used as a loan of any kind, venture funds are invested as equity shares. Venture money is frequently referred to as risk capital due to the investment in shares. Mostly hazardous ventures are the focus of the funding. In general, venture capital is an important source of risk capital, such as funding for shares. It is now the finest financing option available in both industrialized and developing nations. You must possess the following qualities to make a virtual capital investment:

- A company with the potential to expand in the foreseeable future.
- Long-term investments, such as those lasting two to ten years, are preferred.
- The company needs to have invested in a stock of well-established companies with a track record of success.
- The firm's current projects, which guarantee significant levels of returns, should have a high-risk level.
- The investor must continue to be involved once the investment is complete.

A VC fund is described as a fund created in the form of a corporation or business, along with a corporate body, that is registered with SEBI and has a designated pool of money raised by the requirements; Private investment undertakings must be established by these regulations[3]. People can invest money through investment vehicles called private equity funds in freshly established medium and small and start-up companies in return for shareholdings in these businesses. These are financial instruments that regularly make bets on companies with the ability to bring in huge profits but also carry a significant risk.

HISTORY OF VENTURE CAPITAL

The history of venture capital in India began in 1983 with the publication of the country's first risk capital study. It demonstrated how difficulties in raising equity funding and gaining access to the capital market regularly prevent young enterprises from growing and thriving in the long run. It also implied that a comparable return on capital investment was necessary to assess the equity cult as a whole. All of this showed up as institutional flaws and prompted the creation of venture capital. The Risk Capital Foundation was the first organization in India to promote venture capital when IFCO established it in 1975. Acquisition/buyout finance provided the first cash for all small and risky companies.

Types of Venture Capital Funding - The 3 main types are early-stage financing, expansion financing, and acquisition/buyout financing.[4]

Funding for the Early Stage - The three subcategories of early-stage finance are seed funding, start-up money, and first-stage funding.

- Seed funding is a little sum of money provided to a person for them to qualify for a beginning loan.
- Startup money is given to businesses so they may finish developing their products and services.
- Businesses that have used all of their initial resources and need money to continue running their full-scale operations are the main recipients of first-stage funding.

[3] SEBI Venture Capital Funds (VCFs) Regulations 1996
[4] *Ibid*

Expansion Finance - Third-stage or mezzanine finance and bridge financing, are the categories of expansion funding.

- Businesses get second-stage financing to launch their expansion. Mezzanine finance is a different term for it. It is provided to considerably assist a particular firm in expanding.
- Bridge Financing: Companies that employ IPOs as a key business model may be given access to bridge financing, which is a kind of short-term, interest-only borrowing.

Acquisition or Buyout Financing - Acquisition and management financing as well as leveraged buyout financing are two types of acquisition or buyout financing. A firm might purchase a full company or select components with the help of acquisition finance. To acquire a specific product from another firm, a management group may use leveraged buyout finance.

PHASES OF VCF

The Phases of VCI are[5]

Seed Stage: At this phase, a small sum of money is provided to an entrepreneur to market a superior idea that has promise. The investor reviews the company plan before making any investments. The investor may opt not to support the project if he is unhappy with the concept or does not believe the product has a promise. However, the investor may keep putting time and money into the project if some aspect of the idea is workable. The danger factor is fairly significant at this time because there are numerous unidentified components.[6]

Start-up stage: If the proposal or product meets the requirements for further research, the second phase of the process—also referred to as the start-up stage—begins. The following data should be included in the business plan that Venture Capital should now disclose: -

- The executive summary of the business plan;
- A review of the current competitive landscape;

[5] Anna King, 'The five stages of VC funding' (*Gosuperscript*) <https://gosuperscript.com/news-and-resources/5-stages-of-vc-funding> accessed 17 January 2023
[6] *Ibid*

- An analysis of the projected financial statistics;
- Information regarding the management of the business;
- A summary of the industry's scale and capability.

If venture capital is to determine whether or not it will support the firm, it must be given the aforesaid analysis. To finish research and development and initiate the initial marketing strategies, this type of cash is made accessible.

1. Second Stage

The idea has now evolved into a product that can be purchased and sold. Ventures' main goal at this time is to wedge itself among rivals and steal some of its customer dominance and base. Venture capital firms are keeping an eye on the management to assess the player's capability to safeguard the company's design process and also how they manage competitors. if companies discover that their competitors have better talents. If not, venture capital can skip the next phase. At this stage of the financing process, working money is provided for the expansion of the firm, including growing receivables and inventories. The risk factor decreases at this level since the brand is not growing at the earlier release stage. However, it concentrates on the promotion and selling of the goods.

2. Third Stage

It is common to refer to this period as latter-stage finance. A firm with such a basic advertising structure receives funding, frequently for the creation of new products, the advancement of the market, and other uses. Venture capital examines both the goals of the present phase and those from earlier stages, like the second phase, to decide whether the group has accomplished the predicted reduction in cost or not. Venture funders like the latter stage above all others since the risk of failure then is minimal. Companies at this stage also have a managerial record, information on previous results, and a standardized mechanism for gathering financial statements. Risk still is decreasing at this time because the venture relies on the income from selling the existing offering.

3. IPO Stage

The bridge finance phase is another name for this stage. This is the last financial session after taking off. The endeavors now have a certain quantity of shares, giving them the ability to engage in mergers and acquisitions, get rid of rivals, and deter new companies from joining the marketplace. Secondly, Venture must evaluate the company's status and positioning and, if required, restructure this to attract a different demographic.

THE STRUCTURING OF VENTURE CAPITAL FUNDS

The VC fund is structured as follows:

Limited partners (LPs): The amount of cash that a limited partner contributes to the fund is a limitation on their responsibility. Limited partners are shareholders in venture capital funds (LPs). They support the fund as passive investors. Insurance policy companies, pension funds, wealthy people, and other financial organizations are examples of limited partners. [7]

Management Company: The general partners of a venture business may establish a management firm as a distinct legal body. It is responsible for managing the finances of a venture business. The management firm is compensated and pays expenses. In most cases, it is also the proprietor of the fund's logo and trademark. Multi-member businesses are acknowledged as partnerships under U.S. tax rules, while solitary enterprises are the most common for incoming general partners and are classified as "dismissed enterprises.”

General Partner (GP): A venture capital funds management is referred to as a "general partner" (GP). A GP is in charge of procuring capital from a group of investors, making investment decisions, and managing all administrative, accounting, and legal facets of the fund.

[7] Akinchan Buddhodev Sinha, ‘Growth and development of Venture Capital financing in India’ (*ICSI*) <https://www.icsi.edu/media/portals/86/manorama/Venture Capital SSIM BOOK.pdf> accessed 20 January 2023

HOW VCFS WORK (OPERATIONS)

Enterprise equity funds can be classed as startup investment, seed funding, or expansion-stage funding dependent on the company's current maturity at the moment of the financing. However, the phase of the investment has no bearing on how a venture capital firm functions. The venture capital firm searches for shareholders during the equity raising stage, which is the initial step in obtaining funding for a new fund. Prospective investors are provided with a factsheet for the fund before making a financial commitment. All prospective investors are contacted by the fund's managers following a commitment to fulfill certain funds. After that, the VCF searches for venture-capital transactions with the ability to provide maximum profit for its shareholders.

After that, the VCF searches for private equity transactions with the capability to provide profits for its shareholders. The procedure entails the fund manager or managers sifting through numerous company ideas in search of potential high-growth businesses. Fund managers make investment decisions based on the objectives of the investors. After an investment has been made, the fund will be assessed a 2% annual management fee.[8] Investors receive profits when a portfolio company of a venture capital fund merges or goes public. The investors in the fund will then get a pro-rata share of the revenues. If the investment is successful, the fund will keep a portion of the profits in addition to the annual management fee. When a VCF's portfolio firm combines or goes public, shareholders earn. The proceeds will subsequently be divided proportionately among the fund's shareholders. In addition to the yearly management charge, the fund will also keep a part of the earnings if the investment is profitable.[9]

METHODS OF FUNDING FOR VENTURE CAPITAL

Stake in the Company's Equity: In return for a share in the company's equity.

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[8] CFI Team, 'Venture Capital Fund - Overview, Investors, and Types' (*corporatefinanceinstitute.com*) <https://corporatefinanceinstitute.com/resources/wealth-management/venture-capital-fund/> accessed 17 January 2023

[9] *Ibid*

Investing in Debentures: A type of bond issue that lacks any form of collateral security but offers the investor the chance to split the profits.

Contingent Credit: Once the company requesting the funding starts to generate a return, the shareholder is required to repay the contingent loan, which has no interest.

Revenue Notes: These notes combine ordinary lending with contingent loans, demanding relatively modest payments of royalty and interests from the business.[10]

ADVANTAGES OF VENTURE CAPITAL FUNDS[11]

Help in the learning of business experience: The key benefit of venture funding is that it fosters the entrepreneurship of new entrepreneurs.[12] The extensive knowledge of people who provide capital and funds, notably in the fields of HR and financial planning, can indeed be advantageous to entrepreneurs.

Business owners are exempt from repayment obligations- They are not compelled to pay back the money they invested. The financing will not need to be repaid, even if the company fails.

Helps establish crucial connections- Due to their expertise and extensive network, VC providers may help entrepreneurs establish crucial connections. In terms of marketing and promotion, this may be incredibly useful.

Supports the procurement of more funds - By making larger investments in a firm, VC investors try to raise its valuation. They can achieve this by recruiting additional shareholders later on. In certain circumstances, the investment firm may reserve further fundraising phases.

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[10] Diksha Shastri, 'Understanding Various Types of Venture Capital Funding' (*Legalwiz*) <https://www.legalwiz.in/blog/understanding-various-types-of-venture-capital-funding> accessed 17 January 2023

[11] Venture capital, 'Venture Capital: Features, Types, Funding Process, Examples etc' (*Edupristine.com*) <https://www.edupristine.com/blog/venture-capital> accessed 17 January 2023

[12] *Ibid*

Helps with technology update- VC may give small businesses the money they need to update or adopt new technology, helping them to stay competitive.

DISADVANTAGES OF VENTURE CAPITAL FUNDS

Reduced equity: The biggest disadvantage of venture funding is that businessmen have to give up some of their firm ownership. A company may frequently discover that its demands for additional financing are more than expected. In such situations, the owners have to risk losing both their majority ownership position and control over the company**.**

Create a conflict of interest: For startups, investors frequently retain both the major share and the position of chair of the board. The directors and the shareholders may therefore have conflicting interests, which could make choice-making quite challenging.

Receiving permission can be time-consuming: Due diligence must be done by investors before deciding to invest in a start-up. Due to the substantial market analysis as well as economic projections required, this process might take a long time and postpone financing.

Obtaining VC can be difficult: For people with no network, approaching a venture capital company or investor might be difficult.

GROWTH OF VENTURE CAPITAL FINANCING IN INDIA

India's investing system has significantly improved over time. With the introduction of VC funding companies, India has advanced substantially; previously, there were just banking institutions and very few other financial organizations. Business entities focus heavily on expansion since they may get financial assistance from venture capital. The quantity and quality of corporate entities have increased in India. In reaction to the heightened degree of international rivalry, several improvement multinational businesses have invested in investment capital. For venture investment in India, all businesses that engage in product manufacturing, information systems, and contemporary quality service are suitable.

Private equity funding conditions now are vastly different. India has had a venture capital business since 1990. Today, it has effectively expanded for all businesses that take on risky projects whilst yet delivering exceptional potential development. In India, risk capital comes in the form of loans, venture investments, and other forms. In the year 1988, ICICI formed a venture capital fund with the Unit Trust of India. There are already many venture capital firms in India.[13]

Like ICICI Bank, financial institutions have participated in the industry and established their respective private equity units. In addition to Indian investors, international companies have established themselves in India as the commercial bank which makes large firm investments. International investors are also to be thanked for India's enormous growth of its financial markets.[14] India's economy is flourishing as a result of considerable changes in its financial capital sector throughout history. India used to have just a handful of financial and banking institutions, but the country has grown tremendously as a result of venture capital investment. Companies are concentrating on increasing amounts of growth because they can get money from private equity. Corporate entities in India have expanded in size and productivity. Considering the heightened level of worldwide competition, venture capital may be advantageous for a range of development enterprises. Companies headquartered in India that use computer systems, provide products, or provide snipping infrastructure are qualified for venture funding. Although its impact differs by region, the VC business is essential in promoting creativity and inventions.

Anybody in India with a novel concept for a new company with a growing market, a good leadership staff, an innovative corporate strategy, and a strong chance of success is capable of applying for venture funds. Whenever a business satisfies all the requirements for investment, venture capitalists seize the opportunity to invest in it with the hope of generating a significant profit. Before the advent of venture capital, Development Finance Institutions (DFIs) functioned similarly to fund managers by enabling additional profit-sharing aid. The necessity of private

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[13] Neetika Ahuja & Sweta Sinha, 'Venture Capital Funds in India' (Mondaq) <https://www.mondaq.com/india/securities/1079416/venture-capital-funds-in-india.> accessed 17 January 2023

[14] *Ibid*

equity was clear at the beginning of the 1980s when a considerable amount of businessmen burnt their hands in these kinds of enterprises.

The VC industry in India started to get noticed in 1988 after acquiring legal status from the Indian government for activities. The first VC Company was an equal partnership between UTI and ICICI, The Technology Development and Information Company of India Ltd. (TDICI). The investments were originally managed by TDICI and registered as the UTI Venture Capital Unit Scheme (VECAUS). By implementing the Chandrasekhar committee's[15] recommendations, the legal regime for the sector was strengthened, which aided the firm's success.[16]

Throughout time, private equity has grown significantly in amount. 323 contracts had been inked between January 2015 and September 2015, leading to an expenditure of $1.4 billion. According to Venture Intelligence, the first 9 months of 2015 witnessed more mergers than any time before, surpassing the high of $1.2 billion set the prior year (305 agreements). With several regulations and incentives intended for start-ups, the Indian public spending for 2014-2015 expected the construction of an atmosphere that was attractive to investors. During the same period, a 10,000 crore Rs startup pool too was established. Hence, all appeared to be going as planned, and these advancements appeared to herald a successful future for venture capitalists and angel investors[17]. The startup investments increased by 1.17 billion to $1.6 billion in 2022.[18]

ILLUSTRATIONS OF INDIAN VCF

In a new round of fundraising spearheaded by Goldman Sachs and Zodius Tech Fund, Pepperfry.com, the biggest household e-marketplace, has raised 102 million US dollars. Pepper fry would utilize these funds to increase its presence in Tier 3 and Tier 4 cities by introducing an additional logistics network towards its increasing workforce. It also plans to build additional

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[15] Komala G (n 1)

[16] *Ibid*

[17] Tapan Kumar Nayak, 'A Study on the Growth of Venture Capital financing in India' (*Ignited minds Journals*) <http://ignited.in/I/a/304322> accessed 17 January 2023

[18] Amit Pamnani, 'Early stage startup investment is the new sweet spot for VC investors' (*Livemint*) <https://www.livemint.com/opinion/online-views/early-stage-startup-investment-is-the-new-sweet-spot-for-vc-investors-11663499652671.html> accessed 17 January 2023

transportation centers as well as extend its infrastructure of carpenters and installation facilities and services. This represents the greatest sum of money that an Indian firm ever has secured.[19]

Kohlberg Kravis & Roberts (KKR), one of the largest leading alternative financing asset managers around the world, recently committed to invest 150 million US dollars (Rs 965 crore) in Maharashtra-based JBF Industries Ltd., a publicly listed polyester manufacturer. The company will purchase 14.5% casting a vote of negligible mandatorily convertible preference shares in JBF Global Pte Ltd, its wholly owned Singaporean company. This funding from KKR would assist JBF in executing its ongoing projects and initiatives.

SUGGESTIONS

- To boost and develop the venture capital business, the administration must provide financial assistance by omitting the payout ratio to VC fund shareholders from income tax.
- It should be easier to obtain venture capital investment now that private venture capital funds have been established. It allows funding individually rather than as a partnership with financial institutions and other financial organizations.
- Commercial banks should be authorized to classify venture investment capital as "priority sector financing."
- There has to be a change in the notion that private equity is only for the elevated industry. Venture investors should take advantage of the opportunities in biotechnology, food processing, call centers, BPOs, and other industries.
- There shall be lucrative disinvestment choices since every venture capitalist thinks about the exit route when establishing investment strategies in a company.
- The role of the Indian Venture Capital Organization has to be increased. It should establish a registry on the private equity industry to make information accessible to those who are intrigued.

[19] EduPristine (n 11)

- It is crucial to establish coordinating organizations across technical institutes since they can supply the skilled labor needed for the industry's success.

CONCLUSION

It is crucial to choose the right human resources to manage and lead new projects in addition to the organization's finances as the competitiveness of world markets increases. Indian VCs have assured that economic prospects are much more plentiful. VC investors are welcome in a substantial percentage of the economy, such as the medical, computer technology, and other service industries. Consequently, venture investors are favorably receptive to conducting operations in a country there is a risk involved, thus a detailed assessment must be done before starting the process. For elevated businesses, private equity is a crucial way of financing and the secret to increasing both productive capacity as well as job generation.[20] The development, ascent, hurdles, and opportunities that businesses confront when operating with private equity assets are discussed in this article, along with the significance of investment projects in the business world. A businessman may benefit from a private capitalist's assistance in several ways.

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[20] *Ibid*