

## Venture Capital In Global Market

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**Abstract:** “This paper deals about whether a truly global market for venture capital and private equity is emerging or whether the current situation of segmented national market is likely to endure. Here also discussed about categories, stages and process in the Venture Capital funding. It is documented in such a very rapid growth in venture capital fund raising and investment over the past decade in United States, Canada, Israel and India. Here we discussed about the US venture capital investment in India, and its growth. And followed by the advantages and disadvantages of the Venture Capital funding. Nonetheless, we must conclude that the major national markets will remain effectively segmented and suggest that venture capital will continue to be much more important in Common Law than in Civil Law countries for the foreseeable future”.

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### I. Introduction

“Venture Capital (VC) is the capital that is invested in equity or debt securities (with equity conversion terms) of young unseasoned companies promoted by technocrats who attempt to break new path. It is a source of finance for new or relatively new, technologies. It is difficult for the promoters to obtain finance for new or relatively new, technologies. It is a difficult for the promoters to obtain finance from conventional knowledgeable and sophisticated investors who come forward to face higher risks succeed”.

#### What is Venture Capital?

A new private company which does not want to take finance from public markets may have their eyes on Venture Capital (VC). VC is provided to any business firm by those who are willing to invest in the projects that are risky but have a promising future prospect. Such funds are known as “Venture Capital (VC)”.

#### Definition

The National Venture Capital Association (NVCA) defines venture capital as: “Money provided by professionals who invest alongside management in young, rapidly growing companies that have the potential to develop into significant economic contributors.”

“Defined broadly, Venture Capital has been a fixture of western civilization for many centuries. In this context, the decision by Spain’s Ferdinand and Isabella to finance Christopher Columbus’ Voyage of exploration can be considered on of history’s most profitable VC investments (at least for the Spanish). However, modern VC defined as a professionally managed pool of money raised for the sole purpose of making actively managed direct equity investments in rapidly-growing private companies, and with a well-defined exit strategy is a much more recent financial innovation, and one that has until very recently been almost exclusively American”.

Investopedia explains ‘Venture Capital’

“Venture capital can also include managerial and technical expertise. Most venture capital comes from a group of wealthy investors, investment banks and other financial institutions that pool such investments or partnerships. This form of raising capital is popular among new companies or ventures with limited operating history, which cannot raise funds by issuing debt. The downside for entrepreneurs is that venture capitalists usually get a say in company decisions, in addition to a portion of the equity”.

#### Why The Source Of Venture Capital Is As Important As The Money Itself

“Money can be different; it can be “smart” and “not so smart”. When seeding or growing a start-up, it’s critical to attract the “right” investors with “smart” money. While this may fly in the face of conventional wisdom – embrace any investors willing to bet on your business model – entrepreneurs must really pause and consider if they are making an equally shrewd bet on the investor, too”.

**“Important terms relating to VC Fund  
Categorization**

- **Incubators**
- **Angel Investors**
- **Venture Capitalists (VCs)**
- **Private Equity Players**
- **Trust or a Company**

\* **Incubators**

“An Incubator is a hardcore technocrat who works with an entrepreneur to develop a business idea, and prepares a company for subsequent rounds of growth and funding. E Ventures, Infinity are examples of incubators in India”.

\* **Angel Investors**

“An angel is an experienced industry-bred individual with high net worth. Typically, an angel investor would invest only his chosen field of technology, take active participation in day-to-day running of the company invest small sums in the range of USD 1-3 million not insist on detailed business plans sanction the investment in up to a month help company for “second round” of funding”.

\* **Venture Capitalists (VCs)**

“Venture capitalists are organizations raising funds from numerous investors and hiring experienced professional managers to deploy the same. They typically: invest at “second” stage invest over a spectrum over industry/ies have hand-holding “mentor” approach insist on detailed business plans invest into proven ideas/businesses provide ‘brand’ value to investee invest between USD 2-5 million”.

\* **Private Equity Players**

“They are established investment bankers. They typically invest into proven/established businesses. they have “financial partner” approach and invest between USD 5-100 million”.

\* **Trust or a Company**

“A fund established in the form of a trust or a company including a body corporate and registered under SEBI Regulations and which has a dedicated pool of capital, raised in a manner specified in the Regulations and invests in venture Capital undertaking”.

**Venture Capital Fund Generally Provides Following Services:**

- Finance new and rapidly growing companies
- Typically knowledge-based, sustainable, up scaleable companies
- Purchase equity/Quasi-equity Securities
- Assist in the development of new products or services
- Add value to the company through active participation
- Take higher risks with the expectation of higher rewards
- Have a long-term orientation

"VC is money provided by professional who invest alongside management in rapidly growing companies; VC derives its value from the brand equity, professional image, constructive criticism, domain knowledge, industry contacts; they bring to table at a significantly lower management agency cost.

VC financing may be interpreted as an agency relation between the VC (principal) and the E (the agent), the latter selling to the former a stake of his starting-up enterprise. This transaction is governed by Long-term contractual provisions.

VCs typically concentrated in industries with a great deal of uncertainty, where the information gap among Es and investors is commonplace. Therefore, information asymmetries and moral hazard provoke agency costs, related to the E's opportunistic behavior. First, Es might invest in projects that have high personal returns and private benefits but low expected monetary payoffs. Similarly, they have the incentive to pursue high-variance strategies since they claim a all option on the equity capital”.

### How does venture capital work?

When you start a new business, you need money to get it off the ground. You need the money to rent or purchase space for the business, furniture and equipment, supplies, etc. You also need money to pay employees. “There are several places where you can get the money that a new business needs:

- **Personal Savings** -- you can fund the business yourself from savings or by getting a second mortgage on your home.
- **Bootstrapping** -- In some simple businesses, you can bootstrap the business. That means that, with a very small investment, you get the business going and then use the profits from each sale to grow the business. This approach works well in the service industry where start-up expenses are sometimes low and you don't need employees initially.
- **Bank loan** -- You can borrow money from a Bank.

All three of these techniques have limitations unless you are already a wealthy individual. A fourth way to get money to start a business is called **Venture Capital** -- with venture capital you can sometimes obtain large quantities of money, and this money can help businesses with big start-up expenses or businesses that want to grow very quickly”.

## II. Funding

“Obtaining VC is substantially different from raising debt or a loan from a lender. Lenders have a legal right to interest on a loan and repayment of the capital, irrespective of the success or failure of a business. VC is invested in exchange for an equity stake in the Business. As a shareholder, the Venture Capitalist's return is dependent on the growth and profitability of the business. This return is generally earned when the Venture Capitalist “exist” by selling its shareholdings when the business is sold to another owner.

Venture Capitalists are typically very selective in deciding what to invest in; as a rule of thumb, a fund may invest in one in four hundred opportunities presented to it,(citation needed) 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 of providing the financial returns and successful exit event within the required timeframe (typically 3-7 years) that Venture Capitalists expect.

Because investments are illiquid and require the extended timeframe 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 favorable. Venture Capitalists typically assist at **FOUR** stages in the company's development”:

- **Idea Generation**
- **Start-Up**
- **Ramp-Up**
- **Exit**

Because there are no public exchanges listing their securities, private companies meet VC firms and other private equity investors 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, there are some new private online networks that are emerging to provide additional opportunities to meet investors.

This need for high returns makes venture funding an expensive capital source for companies, and most suitable for 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 VC is most prevalent in the fast-growing technology and life sciences or biotechnology fields”.

### Venture Capitalists typically raise funds largely from investors such as

- Financial institutions
- Banks
- Pension funds
- Corporation
- Endowments/foundations
- High Net-Worth individuals

### III. Financing Stages

“There are typically **six** stages of venture round financing offered in VC, that roughly correspond to these stages of a company’s development.

1. **Seed Money:**

Low level financing needed to prove a new idea, often provided by angel investors. Crowd funding is also emerging as an option for seed funding.

2. **Start-Up:**

Early stage firms that need funding for expenses associated with marketing and product development.

3. **Growth (series A round):**

Early sales and manufacturing funds.

4. **Second-Round:**

Working Capital for early stage companies that are selling product, but not yet turning a profit.

5. **Expansion:**

Also called Mezzanine financing, this is an expansion money for newly profitable company.

6. **Exit of Venture Capitalist:**

Also called bridge financing, 4th round is intended to finance the “going public” process between the first round and the fourth round, venture-backed companies may also seek to take venture debt”.

#### Venture Capital Is Key To Our Economic Recovery

“VC, as an industry, has originated in the United States, and American firms have traditionally been the largest participants in venture deals, and the bulk of VC has been deployed in American companies. However, increasingly, non-US venture investment is growing, and the number and size of non-US venture capitalists have been expanding.

VC has been used as a tool for economic development in a variety of developing regions. In many of these regions, with less developed financial sectors, VC plays a role in facilitating access to finance for small and medium enterprises (SMEs), which in most cases would not qualify for receiving bank loans”.

#### Towards A Global Model Of Venture Capital

##### United States

“Venture capitalists invested some \$29.1 billion in 3,752 deals in the U.S. through the fourth quarter of 2011, according to a report by the National Venture Capital Association. The same numbers for all of 2010 were \$23.4 billion in 3,496 deals. A National Venture Capital Association survey found that a majority (69%) of venture capitalists predicted that venture investments in the U.S. would have leveled between \$20-29 billion in 2007”.

##### Israel

“As of 2010, Israel let the world in VC invested per capita. Israel attracted \$170 per person compared to \$75 in the USA. About two thirds of the funds invested were from foreign sources, and the rest domestic”.

##### Canada

Canadian technology companies have attracted interest from the “global VC community as a result, in part, of generous tax incentive through the Scientific Research and Experimental Development (SR & ED) investment tax credit program. The basic incentive available to any Canadian corporation performing R&D is a refundable tax credit that is equal to 20% of “qualifying” R&D expenditures (labor, material, R&D contract, and R&D equipment). An enhanced 35% refundable tax credit of available to certain (i.e. small) Canadian-controlled private corporations (CCPCs). Because the CCPC rules require a minimum of 50% Canadian ownership in the company performing R&D, foreign investors who would like to benefit from the larger 35% tax credit must accept minority position in the company, which might not be desirable. The SR & ED program does not restrict the export of any technology or intellectual property that may have been developed with the benefit of SR&ED tax incentives”.

“Canada also has a fairly unique form of VC generation in its Labor Sponsored Venture Capital Corporations (LSVCC). These funds, also known as Retail Venture Capital or Labor Sponsored Investment Funds (LSIF), are generally sponsored by labour unions and offer tax breaks from government to encourage retail investors to purchase the funds. Generally, these Retail Venture Capital funds only invest in companies

where the majority of employees are in Canada. However, innovative structures have been developed to permit LSVCCs to direct in Canadian subsidiaries of corporation incorporated in jurisdiction outside of Canada”.

#### **Middle East and North Africa**

“The Middle East and North Africa (MENA) VC industry is an early stage of development but growing. The MENA Private Equity Association Guide to VC for entrepreneurs lists VC firms in the region, and other resources available in the MENA VC ecosystem”.

#### **Growth Of Venture Capital In India**

“Scientific, technology and knowledge based ideas properly supported by venture capital can be propelled into a powerful engine of economic growth and wealth creation in a sustainable manner. In various developed and developing economies venture capital has played a significant developmental role. **India, along with Israel, Taiwan and the United States, is recognized for its globally competitive high technology and human capital.** The success India has achieved particularly in software and information technology of success against several odds such as inadequate infrastructure, expensive hardware, restricted access to foreign resources and limited domestic demand, is a pointer to the hidden potential it has in the field of knowledge and technology based industry. India has the second largest English speaking scientific and technical manpower in the world. Some of the management (IIMs) and technology institutes (IITs) are globally known as *centres of excellence*. Every year over 200,000 engineers graduate from Government and private-run engineering colleges. Many also specialize through diploma courses in computers and other technical areas. Management institutes produce 40000 management graduates annually. Given this quality and magnitude of human capital India’s potential to create enterprises is unlimited”.

#### **India With Usa**

“In Silicon Valley, these very Indians have proved their potential and have carved out a prominent place in terms of wealth creation as well as credibility. There are success stories that are well known. They were backed by a venture capital environment in Silicon Valley and elsewhere in US which supports innovation and invention. This also has a powerful grip over the nation’s collective imagination. At least 30% of the start-up enterprises in Silicon Valley are started/backed by Indians. Back home also, as per NASSCOM data, the turnover of software sector in India has crossed Rs 100 billion mark during 1998. The sector grew 58% on a year to year basis and exports accounted for Rs 65.3 billion while the domestic market accounted for Rs 35.1 billion. Exports grew by 67% in rupee terms and 55% in US dollar terms. The strength of software professionals grew by 14% in 1997 and has crossed 160000. The global software sector is expected to grow at 12% to 15% per annum for the next 5 to 7 years. With the inherent skills and manpower that India has, software exports will thrive with an estimated 50% growth per annum. The market capitalization of the listed software companies is approximately 25% of the total market capitalization of around US\$ 200 billion as of December,1999. There is also greater visibility of the Indian companies globally. Given such vast potential which is not only confined to IT and software but also in several other sectors like biotechnology, telecommunications, media and entertainment, medical and health etc., venture capital industry can play a catalyst role in industrial development.

Given the right environment, large flows of risk finance and venture capital can flow into the country. Apart from the foreign investment, substantial venture capital is likely to come from overseas Indian community in Silicon Valley. This is particularly so as some of the Indian technocrat entrepreneurs in Silicon Valley have strong Indian linkages at professional level and are enthused to invest in India. There are at least 300 such entrepreneurs with individual wealth exceeding \$5 million and total wealth of about \$25 US billion. Another 1000 are believed to have wealth in the range of \$ 1-5 million. Currently, about 20% of their wealth is reinvested in new ventures which will rise as vesting schedules mature. The risk capital with Indian entrepreneurs is around \$6 billion and even if 15% to 20% comes to India annually, there is a ready pool of around \$1 billion available for annual venture capital investment in India. Further, larger venture capital firms in the United States with a combined corpus of around US\$ 35 billion have reportedly set aside upto 20% of their funds for investment offshore. India along with Ireland and Taiwan, is a favoured destination for investments by these offshore venture funds.

The net FII investment in Indian markets is around US \$10 billion and the flows for the last few years have generally been positive. With enhanced interest in India as compared to some of the other emerging and Asian markets, given the right environment good amount of money would flow as venture capital investment. This is more so because India has already acquired credibility particularly in the area of information technology and sectors like media, pharmaceuticals etc. While the proportion of offshore to local capital which is around 80% foreign and 20% domestic, may remain same for the first few years, the recycling of entrepreneurial wealth and skills within the industry will gradually lead to greater presence of domestic venture capital industry”.

With this background India is rightly poised for a big leap. This can happen by creating the right environment and the mind set to understand global forces and when that happens we would have created not “Silicon Valley” but the “Ind Valley” a phenomena for the world to watch and reckon with .

### **Some Important Venture Capital Funds In India**

1. “APIDC Venture Capital Limited , **Hyderabad**
2. Canbank Venture Capital Fund Limited, **Bangalore**
3. Gujarat Venture Capital Fund 1997, **Ahmedabad**
4. Industrial Venture Capital Limited, **Chennai**
5. Auto Ancillary Fund, **New Delhi**
6. Gujarat Venture Capital Fund 1995,fs **Ahmedabad**
7. Karnataka Information Technology Venture Capital Fund, **Bangalore**
8. India Auto Ancillary Fund, **Mumbai**
9. Information Technology Fund, **Mumbai**
10. Tamilnadu Infotech Fund, **Mumbai**
11. Orissa Venture Capital Fund,**Mumbai**
12. Uttar Pradesh Venture Capital Fund, **Mumbai**
13. SICOM Venture Capital Fund, **Mumbai**
14. Punjab Infotech Venture Fund, **Chandigarh**
15. National Venture Fund for Software and Information Technology Industry, **Mumbai”**

### **Advantages**

They can provide large sum of equity finance Able to bring wealth and expertise to your company Easier to secure future funding from other sources The business is not obligated to repay the money

### **Disadvantages**

Lengthy and complex process (needs detailed business plan, financial projections and etc.) In the deal negotiation stage, you will have to pay for legal and accounting fees Investors become part owners of your business - founder loss of autonomy or control

## **IV. Conclusion**

"Venture Capital has been vibrant growth in India, with technology dominating the landscape in terms of both number and quantum of investments, as well as exit returns to investors. VC investors have created fundamental value in Portfolio companies, through activities ranging from taking companies global and strengthening management teams, to enforcing robust corporate governance and financial reporting standards. As India move along the path sustained and vibrant economic growth in the coming years technology segments such as enterprise software, digital consumer and engineering will drive the VC investment landscape, and VC investors will continue to play a key role in the Indian as well Global entrepreneurial eco-system”.

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