Role of Venture Capital Financing in India

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ABSTRACT

The study is to assess the major role the Venture Capital funding plays in India. The Venture capital fund is a vital equity source for start-up industries, for the growth of the Indian economy and provides a life saving support for new industries in the prevailing financial markets. Through the venture capital process, the funds are given by professional business groups to invest in certain innovative companies, alongside their management, which are likely to demonstrate rapid growth and have an adequate potential to contribute to significant economic development.

Venture capital signifies that, "Your ideas should flourish with Our Finance," so as to promote entrepreneurs in innovations, to convert their scientific knowledge and technological ideas into a commercial creation and invention. India has shown a significant growth in science, and technological fields in manufacturing and IT industrial segments.

The study will assess the role of Venture Capital in Emerging Economies, the Global Model of Venture Capital, the Structure of Capital Markets and financial institutions, and how to create the Environment for Venture Capital in India to ensure better perspectives for the Indian economy.

Keywords

Financing, Venture Capital, Capitalists, Equity Capital, Banks, Financial Markets, Investment Banking, Evaluation, Funding Process

INTRODUCTION

This article is basically to study the framework to understand the role of venture capital practices in the emerging market. At the time of starting a new company, entrepreneurs turn to several financing options, one of them is venture capital, where the borrowed funds provide support to build a new firm, which possesses the expertise, qualities and characteristics to make something provable and those considered to demonstrate high risk potential and high-growth. Unlike banks and other financial institutions, where the borrowing entrepreneurs are required to pay only the loan amount with interest, in the case of venture capital financing, funds come as a part of ownership in the form of company shares in exchange, to ensure that the shareholders have the limited control, can express their opinions, judgment and have say in the company affairs to direct them in the future.

VENTURE CAPITAL IN EMERGING ECONOMIES: NETWORKS AND INSTITUTIONAL CHANGE

In this global scenario, the emerging economies have turned more mature with all kinds of revolutionary transformations, characterized by comprehensive technological innovations and the fundamental design of subtlety and refinement. The venture capitalists envisage maximum potential for growth in such functions of institutional transformations, as they prefer such environments that primarily differ from other mature markets. In India, when the global fastest growing economy is in transition, entrepreneurial firms expect and try to implement dramatic and rapid shifts in business and institutional environments. Such drastic shifts encounter various challenges that entrepreneurial firms have to face, because, they do not seek only the way to survive, but they have the drive to prosper in this rapidly evolving environment with successful institutional changes. Several research studies have been made to focus on certain institutional changes and witnessed their impact on economic development. But the evolutionary rate of institutions in this transition economy normally has the tendency to be less predictable, while bringing faster changes. The high technological machinery of entrepreneurial firms in India needs to deploy grounded methodology, and applicable theory to comprehend the effective ways the entrepreneurial ventures must work together and integrate to cope with speedy institutional changes, yet manage to be successful and prosper (Nahata, Hazarika & Tandon, 2014).

The fast emerging economies normally lack enforcement, the regulations, and business rule of laws that venture capitalists normally observe in establishing traditional economies. Here we explore the ways venture capitalists develop and utilize networking relationship with entrepreneurs, with other venture capitalists, various enterprises, and many informal institutions to apply and administer different ways and means of investments to replace weaker formal institutions, which are unstable lacking complete business knowledge in the emerging markets. Networking and Institutional Change theory adds cultural and social elements, that provide better socialized clarification regarding the effect and strength of networking, which affects every function of venture capitalist. The grounded theory and methodology is to gather data concerning institutional consequences on venture capital. Four fundamental venture capital functioning categories are; selection of companies with due diligence; monitoring and structuring; value added activities, and exit procedures. Evaluating the company activities and expertise is specifically vital considering inadequately enforced legal system, hence brings several obstacles. Therefore, developing relationship through networking is an adequately stable way to influence the direction of the company. Also, exiting the venture is constrained because listing the company has a limited scope, while the corporate market control remains weak, enforcing the bankruptcy code also does not exist. Therefore, in the emerging economic conditions, the networking method is applied to obtain precise information, effective monitoring, to follow rules of law, for contract enforcement. Analyzing the overall system, The overall analysis indicates the networking impact, with respect to changing institutional systems in case of transitional progression in the emerging economy (Ahlstrom & Bruton, 2006).

TOWARDS A GLOBAL MODEL OF VENTURE CAPITAL

It is not necessary that the venture capitalists invest funds only in the starting period of the company. They also continue funding at multiple stages, depending on the company's progress. NVCA- National Venture Capital Association research study revealed certain spectacular investments made by venture capitalists in 2010, investing around $24 billion in 2,770 companies, out of which, 1,000 companies accessed funds at the initial stage of the company. (Lerner & Tåg 2013). The most popular companies which received venture capital funds in the startup period are Compaq, Apple, Google and Microsoft (Lerner & Tåg 2013).

The main theme of Global Model of Venture Capital is to provide some context to understand the entire operating system of venture capital industries. This includes the entire information concerning the industry nature, size, the main players, the nature and amount needed as venture capital investments. (Liang & Yu, 2011).

Thereafter, a detailed investigation needs to be conducted to ascertain the methodology by creating a venture capital model to take investment decisions. Normally, the venture capitalists utilize the standardized framework of generic criteria, which identifies all six-stages of the proposed model. The origination process, screening of specific venture capital firms, using generic screening method, the initial and primary phase evaluation method, the further and second stage of evaluation, and finally the closing stage. Every act is to evaluate and perform different activities that occur at every stage. It is understood that the venture capitalists provide an intensive information concerning demand side and supply-side of marketing benefits (Woike, Hoffrage & Jeffrey, 2015). Using the technique of computer simulation, the impact of various strategies can be investigated concerning the venture capital financial performance. If we assess and compare ordinary heuristics, offering equal, fast, frugal and more complex learning machine with regression model, we can analyze the influence of three stages learning venture capital, the statistical characteristics and properties concerning the environment for investment, and the total business plan information available. We can evaluate the performance related to decision strategy, linked to the outcome of decision quality that can change drastically between the environmental factors holding various statistical relationships between business plans data contains and related financial success. The similar circumstances arise in case of more complex and competitive strategic investment decisions, while its performance remains robust in the entire environment. It is the best way to learn those business plans, which simulate and guide VC investments. The overall results clarify the difference in decision strategies differ to that of the impact generated due to additional information about decision outcome. Finally, there is a need to evaluate the real-world implication VC practices, study and research on precise VC surety in decision making (Anjos, Fernando & Drexler, 2015).

VENTURE CAPITAL AND THE STRUCTURE OF CAPITAL MARKETS: BANKS VERSUS STOCK MARKETS

The Capital Market is perhaps the highly preferred and widely hunted markets. Both markets of bonds and stocks are always closely studied, their daily movements are rigorously analyzed and followed as they remain proxies for the overall economic affairs of the entire global markets. Hence, those operational capital market institutions like commercial banks, stock exchanges, and similar kind of corporations, non-banking institutions like mortgage banks and insurance companies are cautiously scrutinized (Da Rin, Nicodano & Sembenelli, 2006).

There are similarities and differences between money and capital markets. Viewing from the seller or issuer standpoint, these two markets generate required business functions, sustaining enough funding levels. The seller's market goal depends on their time based liquidity needs. While the buyers or investors pursue the market, investments with unique reasons. There is a higher risk in capital market investments, whereas, the money markets bring safe assets; the returns from money market are steady but low, and the capital market offers better and high returns. The capital market magnitude of returns has a clear connection to risk level, but this is not always (Da Rin, Nicodano & Sembenelli, 2006).

Even though all markets demonstrate long term efficiency, those exhibit short-term inefficiency provide investors to exploit on irregularity to gain higher rewards, which at times go out of control with respect to risk level. These exact anomalies all the capital market investors try to evaluate and study. Even though, money market is known to be safe, the investors encounter negative returns. Unexpected risks, that may be unusual, always an inherent risk in investments, even in the case of short or long term, capital and money market can be very risky at times (Da Rin, Nicodano & Sembenelli, 2006).

The USA has several small banks in relation to large companies. They play a restricted role in terms of corporate governance, and well established stock market and associate markets to gain corporate control. In another way, Germany and Japan have less, but larger banks, those play a very dynamic role of central governance. But, they do not possess corporate control active market rules. Bank procedures and rules in relation to stock and capital market system have systematic differences between their systems, because the venture capital stock market systems possess greater vitality. To understand the connection between venture capital and stock market needs an awareness of contractual arrangements of entrepreneurs with venture capital providers; specifically while entering into an implied contract control, which permits successful entrepreneurs to reacquire the company share value from venture capital investors. It can be done using public offering initially, by which venture capitalists can exit from their portfolio investments. There is a need to study to understand venture capital procedures of contracting, the venture capital market, quick exit procedures by VC investors; and systematic exit process by preliminary public offering (Gilson & Black, 1997).

CREATING AN ENVIRONMENT FOR VENTURE CAPITAL IN INDIA

The VC- Venture Capital institution is too complex to commence because of policy intervention, specifically in this developing country like India, where an unstable macroeconomic environment persists, with the historical use of national funds and state capital involvement prevails in the industrial production composition. India carries several of such constraints. The year 1985 emerged with flourishing software industries, generating the best raw materials venture capitalists are looking to finance. Thus, the industry received the fundamental precondition for the growth of venture capital funds. This generated booming industry of venture capitalists. After different setbacks, little success was realized mainly because of slow molding processes of environmental regulations and rules, related to permit institutions. The overseas Indians assisted with their roles in the success of Silicon Valley entrepreneurs in the later part of the twentieth century. Yet, the combined work of practitioners and policymakers is to be processed to give a proper shape to the Venture Capital institution (Landstrom & Mason, 2014).

Venture Capital has turned out to be the driving force in every business sector for quick economic growth and industry developments. Its importance is growing faster in all sectors, as can be seen, there are many famous companies world over who have received VC or funding from business angels in their initial company development. Hence, it is necessary that business managers and entrepreneurs understand the precise tools, strategies, and techniques to secure financial support from the VC. India needs to explore and evaluate the importance and value of the globalization modules of the VC Institution (Lerner, Leamon & Hardymon 2012).

This modular framework is elaborate, extensive, intended to educate entrepreneurs to understand how in the initial stages of company starting, funding is generated and procured from venture capital companies, and further to access and evaluate the ways and strategies that help working alongside the industries and how to manage investments. This criteria stays inline with the Private

Equity modules, Entrepreneurial Finance, which offers an elaborate information on the analysis and production of company financial status and information for the entrepreneurs to understand, and the extensive array of debt / equity financial schemes and methods available (Lerner, Leamon & Hardymon 2012).

This kind of modular framework provides an elaborate knowledge of the capital investment procedures, decision making and screening processes, business proposal, selecting and negotiating techniques, structure to make the deal, following up on the amount of investments made and exiting formats (Landstrom & Mason, 2014).

VENTURE CAPITAL, PRIVATE EQUITY AND THE FINANCING OF ENTREPRENEURSHIP

The venture capital or Risk Capital, private equity, investment banking develops the financial service system. However, the structure of their fund investment is unique. Private equity firms are the factions of private investors. They use their funds to buy assets or the complete businesses. Venture capitalists invest funds to new entrepreneurs in their start up businesses, as they can acquire more resources to develop the business. Investment banks have several other functions (Lerner, Leamon & Hardymon, 2012).

Private Equity

Investors of Private equity merge multiple investor assets to implement transactions. They pool all resources, and purchase sections of any business or take control of the company in distress. However, they do not take business ownership permanently. Instead, they create an exit strategy. These Private equity companies try to improve the acquired business so as to sell with a substantial profit. Such equity measures are risky due to their large investments to clear debt and to complete the deal (Lerner, Leamon & Hardymon, 2012).

Venture Capital

The investment banking and private equity offer service facilities to various corporations having a good operating reputation and history. Venture capitalists invest in the early stages of business operations. They are prepared to take additional risks to fund new businesses, so as to help commence business operations and earn profits. This provides new businesses the requisite initial funds and turns an attractive proposal than to avail funds from those of private equity or investment banking (Lerner, Leamon & Hardymon, 2012).

Investment Banking

Venture capitalists, private equity investment firms and bankers generally offer support to secure funds from different other investors. While investment bankers utilize financial markets, that includes equity and debts to finance corporate transactions. Bankers also help finance different companies to form acquisitions, and mergers, sell debt shares and equity in capital markets, may be through restructuring corporation management. For example, in the year 2012, the investment banker pay structure changed as per the Bloomberg published article. At that time, very less bankers were entitled to gain bonus during year end, and they were also earning bigger salaries (Lerner, Leamon & Hardymon, 2012).

Regulation

Financial regulations have become very stringent due to the 2008 economic and financial crisis, that led to the formation of the Dodd-Frank law, which governs major parts of financial service industry. Due to this, investment banking rules have turned excessively large and cumbersome to deal with, as per The New York Times article of 2012. It states that all the Private equity companies were under inquiry and scrutiny, as they pocketed more profits than their share from every deal. This was published in an article on Bloomberg in September 2012. They claimed that the VC companies sidestepped the normal lawful, but expensive procedural needs of registering with government regulations stipulated by the Dodd-Frank rules, which mainly considers a break for such firms (Lerner, Leamon & Hardymon, 2012).

CONCLUSION

The VC can provide a large amount of funds for businesses and for capital development that is not feasible through any bank loan or any other conventional means.

Venture capitalists also provide relevant business expertise, connected with industrial progress and those guidance and mentoring processes is extremely valuable.

Legal costs and accounting processes make the fund securing procedure through VC very difficult. In case a requisite deal is secured, the investors of VC will primarily get drawn in to decide on company affairs, strategies and directions.

However, Securing the capital from VC is very cumbersome, while the funds invested in any innovative venture may have a huge potential for profits as well as risks of losses are rigorously evaluated and considered. (Hellmann & Puri, 2000).

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