International Journal of Education, Modern Management, Applied Science & Social Science (IJEMMASSS)
ISSN : 2581-9925, Impact Factor: 5.143, Volume 02, No. 03, July - September, 2020, pp.05-07

VENTURE CAPITAL FUNDING "A MODERN WAY TO FINANCE"

Dr. Pankaj Kumar*

ABSTRACT

The traditional and safest way to finance others business is always club finance. That is financing one business by lot of people, so that risk is diversified between numbers of people. This definitely has a drawback that return is also divided among all but still risk becomes lesser. Funding through share capital probably is best classic example of the same. Where a person called promoter introduce an idea and forms a business called company and invites people to invest in his business for sake of stake. However this need a strong reputation in market as well as the idea must be so attractive in terms of return as well future forward oriented. But what happens when a person having an attractive idea but without a strong Goodwill and reputation in the market. How to than materialized the idea? Some one could say by borrowing from financial institution, but too need mortgage, which is also not available. In that case you need an angel (Investor) who is ready to invest in your business with Risk involved, without considering your market Reputation and Goodwill and even without any security, but just on the basis of your idea and enthusiasm. This we are going to discuss in this article known as Venture Capital Financing".

Keywords: *Venture Capital Finance, Angel Investor, Return on Investment, Risk Involved*.

Introduction

"A have an Idea but don't know how to implement the same. What's the problem? I don't have plenty of money to invest even though my idea is superb" we heard such words many times from various upcoming, enthusiastic and probable entrepreneurs. Due to this problem of finance or capital perhaps Lakhs of ideas goes into garbage boxes every year, which could if had came on table, would result into a massive change to the entire business world. But unfortunately it does not happen. Finance is the back bone of any business idea which probably enriches the business from its roots. This problem becomes a mess with those young entrepreneurs who don't have any security to pledge as well as any guarantee. Just because of this, a new concept of finance came into picture where some investors invest their money, undoubtedly with lot of risk but looking forward with great returns. This new method of finance is known as Venture capital financing in the easiest possible manner.

A Venture Capital Fund provides finance to new entrepreneurs with the financial support they need, to begin as well as to expand their business to scalable and sustainable growth, simultaneously providing ventures outstanding returns for the higher risk they taken. Venture Capital find generally finances Rapidly growing companies (So that the time involved in converting the investment into return is quite low), which are technology driven typically knowledge based, sustainable too and up scalable, in lieu a portion of equity and some time also participate in management to a great extent. Sun, Microsoft, Infoway, rediff are the few names of venture capital financing.

Regulatory Mechanism

In India the Venture capital Financing is governed by number of statutory Regulations. These includes Guidelines issued by Securities Exchange Board of India, Guidelines and provisions issued by Central Board of Direct Taxes relating to proceeds from Venture Capital Financing Activities, Companies Act, 2013 or Indian Trust Act or Limited Liability Partnership Act, 2009 also applies depending upon the

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6 (M.Com. Ph.D.) Village & Post-Pillich, District -Nalanda, Bihar, India.

nature of Constitution of Venture Fund (Generally it is in nature of LLP), Ventures funds of any country outside India need the permission and clearance of Reserve Bank of India and Foreign Investment Promotion Board while setting up of their units or financing any Indian entrepreneur. Apart from all above there are other number of agencies of government such as ministry of finance, department of economic affairs, etc. from where permission is to be sought while setting up of the business.

However due to this complexity of number of laws and trap of their provisions, most of the Foreign Venture capital Finance prefer to list out themselves in offshore fund operating countries where double tax avoidance treaties exist and they can also freely repatriate there funds.

However to help venture capitalists a voluntary Organization formed by Indian Venture capital funds has been formed. This organization acts as representative of venture capital funds and it has been set up on the lines of British Venture Capital Association. The main aim of this organization is to bring cooperation and coordination among the venture funds, setting up of the uniform line of working with predefined professional Standards, to promote its members to work in an organized manner and conducting various training programmes for its members.

How Venture Capital Finance Works

Although there is no specific process identified or lay down under any policy or regulation or even in any literature regarding the process or stages of Venture Capital Finance. However as per various authors in their opinion and Venture capital financiers through their experience has suggested 5 different stages of Venture capital Financing. These are Seed Stage, Startup stage, Performing stage, Extension stage and Pool up stage (Also known as Bridge Stage).

- **Stage 1: Seed Stage –** At this stage the entrepreneur has an idea for a product or service and he has to convince the investor or investors about the success of his product or service, in terms of return. He has to justify that his idea has a viable Investment opportunity and will be fruitful to investor. If investor satisfies with idea, he make available funding to finance the initial operation cost of the project such as market research and analysis, Product initial Development, Development of Business Plan, setting up of management team. However at this stage venturer work alongside with other entrepreneurs too.
- **Stage 2: Start up Stage -** This stage starts when entrepreneur complete his research and analysis and has come out with a strong business plan and has satisfied the investor with sure return on investment with his business plan. At this stage more capital is required for an aggressive marketing and expansion to a varied level or range of customers.
- **Stage 3: Performing Stage –** This is the stage where entrepreneur has to perform actually and he need almost total amount of funding for running the business and launching of his product or service. This is the stage where most of product are commercially viable and are return worthy. At this stage the entrepreneur is also become eligible for funding from other sources too, such as bank financing. Also the venturer is also ready to finance more amount compare to as committed at the beginning.
- **Stage 4: Extension Stage –** Up to stage 3rd the business has already started producing the service or goods and selling them. However it needs more capital to expand its business or to enter into new line of business or market expansion. This stage do not necessarily comes in all the business because all business does not have expansion plans or enter into a new line of business. But this stage too has one similar factor as of stage 3 i.e. at this stage also the other source of funding is available. Hence dependence on Venture capital financing for expansion not remains at all.
- **Stage 5: Pool up Stage –** This is the stage where the Venturer finds suitable to exit from the business with converting his investment into cash. The business now opens for all other investors including the retail investor so by their entry, the venture capitalist may exist. One classic way is to convert the sole business into a public limited company and issue the capital to the public at large and let the public come into the company with the portion of equity equal to or more than it and pay off the capital of venture capitalist or venture capitalist may sale his equity to other investors.

Venture Capital Finance in India

The venture capital financing was originally started in US where it found tremendous success, no doubt not in a day but over a period of time. In India, the venture capital financing was started at very small level somewhere near to 1986. It was started with establishment of Credit Capital venture Fund

(India) Ltd. set up by Credit Capital Finance Corporation Ltd. In public sector there was also a setup by Industrial Credit and Investment Corporation of India and UTI jointly. However now the span of Venture capital financing has extended to large extent and now even increasing rapidly. The reason of such increase is lie in the history of India since independence. In first 4 decade of since independence, the entire industrialization was dependent upon imported technology and family managed businesses. However with the introduction of concept of liberalization, the new class of professional exposed to the whole world and their innovative skills and technical expertise came into eyes of global leaders and financiers. The success of such large number of professionals undoubtedly attributed to venture capital financing. However still the venture industry has not reached at its divestment stage and hence it will be too early to comment on success of Venture finance in India. In India most of venture capital finance groups are unlisted and hence it is difficult to assess the exact level of this. The trends, no doubt show the results which are much better than expectation. Few of the reasons because of which it has not reached at its best level may include Governments support in formation of risk capital is limited up to tax reliefs only, unwillingness on the part of most of investors, since in venture financing a portion of the control vests with Venturer, hence entrepreneurs are reluctant to take finance form Venture capital finance, Indian entrepreneurs are conservative in thinking and always afraid of losing control in business when it expands etc. However a lot of scope is still open to work. It is still open to take off.

At present more than 100's of venture capitalist are working in india and financing thousands of the young entrepreneurs and businesses and seeding the economic structure of india and making it grow at the world level. With the due expansion of the same as well as the government policy breakthrough with ease of business and financing, the venture capital financing may grow drastically. The political will has never came into this side of path of financing in india where every year lakhs of business ideas do not come on platform just because of the sake of capital. If this has been the keen interest of the government the India would have been the next giant in producing the maximum number of entrepreneurs.

Conclusion

As we discussed a Venture Capital Fund provides finance to new entrepreneurs with the financial support in lieu of outstanding returns for the higher risk they taken. The Success story of various giant size companies like Federal Express, Microsoft, Rediff etc speaks a lot about emerging role of Venture Capital Financing. In last two decade it has emerged as an important area of finance. The recent success of number of professionals in creating a whole new world of business is largely attributable to Venture Capital Financing. However Venture Capital Financing is growing unexpectedly well still most of the finance made by ventures is in unlisted companies. So it can be said that it is still in the baby age. The probable reason may be lack of finds and support from Banks to ventures, Unwillingness of investors due to fear of risky projects, most important lack of proper legal framework and last but not the least limited exits from the project once entered. Hence still it need a lot of exposure specially towards not big size but at least medium size Businesses.

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