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Challenges of venture capital financing in India: A study

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Abstract
The concept of venture capital deals with the large amount of financing to start big projects. Venture Capital is money provided by professionals who invest in fast growing companies that have the possible to expand into important economic contributors. According to SEBI regulations, venture capital fund means a fund well-known in the form of a company or trust, which enhances capital in the form of money through loans, issue of securities, donations or and makes or proposes, to make investments in accordance with these regulations. The funds so collected are available for investment in potentially highly profitable projects at a high financial risk of loss. A Venture Capitalist is an individual or a company who provides, Investment Capital, intellectual management expertise while funding and running highly innovative & prospective areas of products as well as services. In India, presently, there are many institutions which provide venture capital finance. There is an urgent need for encouragement of risk capital in India, as this will widen the industrial base of, high tech industries and promote the growth of technology. This research paper is an aiming to highlight the issues and challenges faced by Indian venture capital companies while financing.

Keywords: capital, money, investment, company, issues

Introduction
Venture capital refers to the finance provided by venture capitalists, who invest in relatively new, high growth companies or startups that have a potential to growth and develop into highly profitable ventures. It has-high risk and high-return personality. So, it acts as a vital source of finance for entrepreneurs with new ideas. According to SEBI regulations, venture capital fund means a fund well-known in the form of a company or trust, which enhances money through loans, issue of securities, or donations and makes or proposes, to make investments in accordance with these regulations. The funds so collected are available for investment in potentially highly profitable projects at a high risk of financial loss. A Venture Capitalist is an individual or a company who provides Investment Capital, Intellectual, Management Expertise, Networking & marketing support while funding and running highly innovative & prospective areas of products as well as services. Thus, the investments made by Venture Capitalists consisting; Financing new and rapidly growing projects, enterprises or companies, Buying equity and other securities, Taking high risk expecting high return on investment, Having a long frame of time period, normally of more than 5 to 6 years and Marketing and promotions of the product /service being obtainable. (Viren chavda, 2014) [1].

Importance of the Study
Venture capital institutions let entrepreneurs exchange their knowledge into viable projects with the assistance of such venture capital institutions. It helps new products with modern technology become commercially feasible. It promotes export oriented units to earn more foreign exchange. It not only provided the financial institution but also assist in management, technical and others. It strengthens the capital market which not only improves the borrowing concern but also creates a situation whereby they can raise their own capital through capital market. It promotes modern technology through the process where financial institutions encourage business ventures with new technology. Many sick companies get a turn around after getting proper treatment from such venture capital institutions.

Statement of the Problems
First, there is a serious mismatch between the kind of venture capital obtainable in India and what the market demands. Almost all VCFs in India have been targeting their capital at companies in the information technology, pharmaceuticals and some services industries, looking for expansion financing of Rs 15 crores or more. Now, this is a limited market segment. Most of the industries mentioned above are relatively young. There are very few firms in these sectors, seeking large amounts of capital for expansion financing. At the same time, a large number of aspiring entrepreneurs, start-ups, early- stage companies and Old Economy firms, which are fundamentally sound businesses, are unable to attract the VC financing that they badly need in order to grow. Apart from the relatively smaller amounts of funding that they seek, on average start-ups require considerable post-funding support from the investor to grow their businesses. That is painstaking work, for which Indian VCF managers have demonstrated neither experience nor training nor temperament. Old Economy firms do not provide the quick or glamorous exits that VCFs often desire.
Second, most VCFs in India are an extended support or a division of global investment institutions. International funds represent more than 95 per cent of the VC invested in India. Two penalties follow from this near-total dependence on foreign capital. One, the investment mandates of these VCFs are often driven by the parent institutions' global world view, which often ignores local market needs. The homogenous investment preferences of VCFs outlined

earlier follow from the parent institutions' global investment strategies. Two, at a portfolio level, every international VC investor in India has been a victim of the depreciation of the rupee against the dollar. The returns produced by Indian VCFs, measured in US dollars or other Western currencies, turn out to be considerably less attractive than that measured in Indian currency. Many nations such as the Netherlands, Portugal, Finland, Norway and Israel recognized the limitations of depending on foreign funds at the time of evolving a policy for developing a local VC industry. Their first step was to kick start VCFs in the private sector with funds from domestic institutions. Over a decade, or even less, they succeeded in creating a local VC industry that depended less and less on government support and international investors.

The third issue is the poor quality of corporate governance and lack of sensitivity among entrepreneurs and investors, to each other's legitimate business aspirations. This is a universal difficulty and not unique to India. What is however unique to India is the hopeless system of legal redress of grievances when partners renege on contractual obligations. Often, aggrieved parties in India agree to settlements that are unfair to them, apprehending that litigation in Indian courts could be dysfunctional. This situation may not change in the estimated future. The alternative to litigation and unfair bad investments would be to invest more effort in better recognition and selection of investments and supervision of the portfolio. Indian VCF managers need to ask themselves if they are prepared to put in that extra effort to minimize prospects for legal action in the first place.

Last, but not the least, the industry lacks a broad-based and effectual trade association. The Indian Venture Capital Association (IVCA) does not represent a large proportion of the VCFs who are active in India. I am not sure of the IVCA's contributions to the VC industry either, in the ten years since it was formed. For some years initially, the IVCA used to produce a pleasantly uninformative annual report, many months after the end of the year. For the past four years even those reports do not appear to have been published! Venture capital has been a remarkable catalyst of entrepreneurial activity, after the Second World War, in many developed countries. It has led to important growth in industry and innovation. The prospects for the Indian VC industry are no less humongous. It is up to the industry to reflect on its current predicament and evolve a strategy to seize the opportunity.

Objective of the Study

1. To highlight the issues and challenges faced by Indian venture capital companies while financing.

Procedure for Venture Capital Financing

Venture capital starts up with financing to help technically sound, globally competitive and potential projects to compete in the global markets with the high quality and reasonable cost aspects. The growth of South East Asian economies especially Hongkong, Singapore, South Korea, Malaysia along with India has been due to the large pool of Venture Capital investment from domestic or offshore arenas Venture Capitalists draw their investment funds from a pool of money raised from public as well as private capitalists. These funds are deployed collectively as equity capital (ordinary and preference shares capital) and sometimes as subordinated debt which is a semi secured investment in the company (through debenture) ranking below the secured lenders that often requires periodic repayment. Today, a venture capital deal can involve common equity, convertible preferred equity and subordinated debt in variable proportions. The Venture Capital funding varies across the different stages of growth of a firm. The various stages are as follow:

1. Pre seed Stage: In this stage small amount of capital is provided to an entrepreneur to dreamt and market a potential idea having better future prospects. The funded work also involves product development to some extent.
2. Seed Stage: This type of Financing is provided to complete product development and commence initial marketing strategies.
3. First Stage: Finance is provided to companies to initiate commercial manufacturing and sales.
4. Second Stage: In the Second Stage of Financing working capital is provided for the expansion of the company in terms of growing accounts receivables and inventory.
5. Third Stage: Funds provided for major expansion of a company having increasing volume of sales. This stage is met when the firm goes beyond the breakeven point.
6. Later Stage Financing: Later Stage Financing is financing a company just before its IPO (Initial Public Offer). Often, bridge finance is structured so that it can be repaid, from the proceeds of a public offering.

There are basically four major elements in financing of ventures which are studied in depth by the venture capitalists. These are as under:

1. Top Management: The strength, expertise & unity of the key people on the board bring significant credibility to the company or enterprise. The members are to be mature, experienced having working knowledge of business and capable of taking potentially high risks against high return on venture investment.
2. Realistic Financial Requirement and Projections: The venture capitalist requires a realistic view about the present financial position of the organization as well as future projections regarding scope, nature and performance of the company in terms of scale of operations, operating profit and further costs related to product development through Research & Development.
3. Expectation for Capital Gain: An above average rate of return of about 30% to 40% is required by venture capitalists. The rate of return also depends upon the stage of the business cycle where funds are being deployed. Earlier the stage, higher is the risk and hence the return on it.
4. Owner’s Finance: The financial resources owned & committed by the entrepreneur/ owner in the business including the funds invested by family, friends and relatives play a very important role in increasing the viability of the business. It is an important avenue where the venture capitalist keeps an open eye.

Problems and Issues in Venture Capital Financing

Venture Capital Financing is in its abortive stages in India. The emerging global competitiveness has put an immense pressure on the industrial sector to improve the quality level with minimization of cost of products by making use of latest and advanced technology. The implication is to obtain adequate financing along with the necessary hi-tech equipments to produce an innovative product which can succeed and grow in the present market condition. Unfortunately, India lacks on both fronts. The required capital can be obtained from the venture capital firms who expect high and risky rate of return on the investment. The financing firms expect a sound, experienced, mature and capable management team of the company being financed. Since the innovative project involves a higher risk, there is an expectation of higher returns from the project. The payback period is also long (5 to 7 years). The various issues and difficulties of venture capital financing are as follow;

1. Requirement of an experienced managerial team.
2. Requirement of high rate of return on investment.
3. Payback period is normally long.
4. Uncertainty regarding the success of the product in the market.
5. Problems and issues regarding the infrastructure details of production like plant location, accessibility, relationship with the suppliers and creditors, transportation facilities, labour availability etc.
6. The category of potential customers regarding products and service offerings.
7. The size of the market.
8. Major rivals and their market share.
9. Skills and Training required and the cost of training.
10. Financial considerations like return on capital employed (ROCE), cost of the project, the Internal Rate of Return (IRR) of the project, total amount of funds required, ratio of owners investment (personnel funds of the entrepreneur), borrowed capital, mortgage loans etc. in the capital employed.

Features of Venture Capital fund in India

The key terms found in most definition of Venture capital are: high technology and high risk, equity investment and capital gains, value addition through participation in management.

High Risk

By definition the Venture capital financing is highly risky and chances of failure are high as it provides long term startup capital to high risk-high reward ventures. Venture capital assumes four types of risks:

1. Management Risk-inability of the management teams to work together.
2. Market Risk- product may fail in the market.
3. Product Risk- product may not be commercially viable
4. Operation Risk- operations may not be cost effective resulting in increased cost and decreased gross margins.

Conclusion

The world markets are becoming more and more competitive. Companies are required to be super-efficient with respect to cost, productivity, labour efficiency, technical skills, varied consumer demand, adaptability and foresightedness to get competitive edge over the rival firms. There is an imminent demand for highly cost effective, quality products and so, the need for right access to valuable human capital to guide and monitor along with the necessary funds for financing the new projects. Today India is promoting venture capital financing to new projects, innovative ideas, liberalizing taxation regulations providing tax benefits to venture capitalist. There are large sectors of the economy that are ripe for venture capital investors, like, information technology, engineering, Pharma, Manufacturing industries and other service industry too. The nation waits for the rapid venture capital funding business in India inspite of the existing problems in the Indian industrial infrastructure.

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