Article ID 240202055

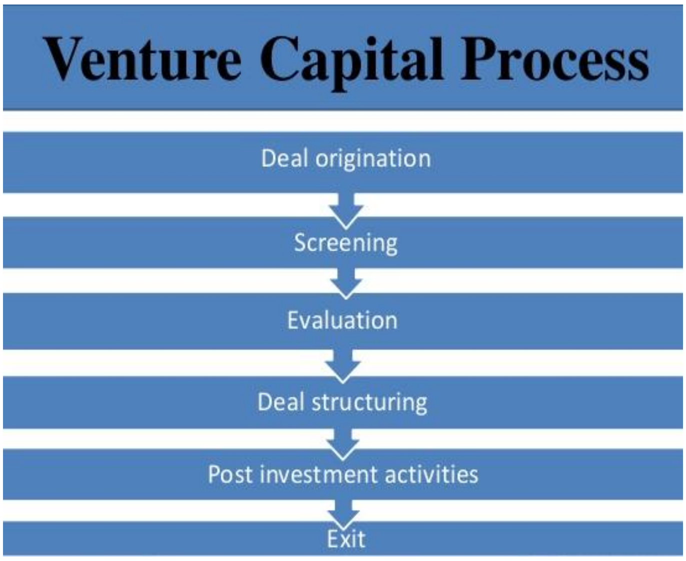
Venture Capital: Concept and Process

Niyati Thakur
Dr. Yashwant Singh Parmar UHF Nauni, Solan HP 173230
*Corresponding Author: thakniyati18ur@gmail.com

Venture capital (VC) is a form of private equity and a type of financing that investors provide to startup companies and small businesses that are believed to have long term growth potential. Venture capital generally comes from well-off investors, investment banks, and any other financial institutions. However, it does not always toke a monetary form it can also be provided in the form of technical or managerial expertise. Venture capital is typically allocated to small companies with exceptional growth potential, or to companies that have grown quickly and appear poised to continue to expand the six steps involved in the process of venture capital financing.

The steps are

1. Deal Origination
2. Screening
3. Evaluation
4. Deal Negotiation
5. Post Investment Activity
6. Exit Plan



Deal Origination

Venture capital financing begins with origination of a deal. For venture capital business, stream of deals is necessary. There may be various sources of origination of deals. One such source is referral system in which deals are referred to venture capitalists by their parent

Screening

Venture capitalist in his endeavor to choose the best ventures first of all undertakes preliminary scrutiny of all projects on the basis of certain broad criteria, such as technology or product, market scope, size of investment, geographical location and stage of financing. Venture capitalists in India ask the applicant to provide a brief profile of the proposed venture to establish prime facie eligibility. Entrepreneurs are also invited for face-to-face discussion for seeking certain clarifications.

Evaluation

After a proposal has passed the preliminary screening, a detailed evaluation of the proposal takes place. A detailed study of project profile, track record of the entrepreneur, market potential, technological feasibility future turnover, profitability, etc. is undertaken. Venture capitalists in Indian factor in the entrepreneur's background, especially in terms of integrity, long-term vision, urge to grow managerial skills and business orientation. They also consider the entrepreneur's entre-preneurital skills, technical competence, manufacturing and marketing abilities and experience. Further, the project's viability in terms of product, market and technology is examined.

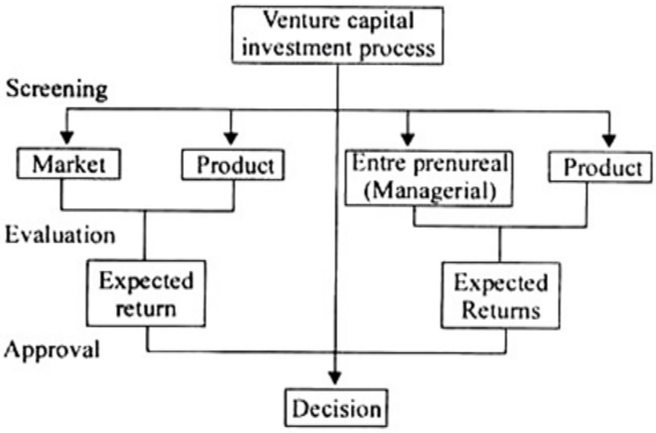


Fig 1: Venture Capital Investment Process

Source: Typsee and Burno (1984)

Deal Negotiation

Once the venture is found viable, the venture capitalist negotiates the terms of the deal with the entrepreneur. This it does so as to protect its interest. Terms of the deal include amount, form and price of the investment. It also contains protective covenants such as venture capitalists right to control the venture company and to change its management, if necessary, buy back arrangements, acquisition, making IPOs. Terms of the deal should be mutually beneficial to both venture capitalist and the entrepreneur. It should be flexible and its structure should safeguard interests of both the parties.

Post Investment Activity

Once the deal is financed and the venture begins working, the venture capitalist associates himself with the enterprise as a partner and collaborator in order to ensure that the enterprise is operating as per the plan. The venture capitalist's participation in the enterprise is generally through a representation in the Board of Directors or informal influence in improving the quality of marketing, finance and other managerial functions. Generally, the venture capitalist does not meddle in the day-to-day working of the enterprise, it intervenes when a financial or managerial crisis takes place.

Exit Plan

The last stage of venture capital financing is the exit to realize the investment so as to make a profit/minimize losses. The venture capitalist should make exit plan, determining precise timing of exit that would depend on a myriad of factors, such as nature of the venture, the extent and type of financial stake, the state of actual and potential competition, market conditions, etc.

Sources of venture capital

The concept of venture capital has become a worldwide concept in the field of risk financing of industrial projects. The development of venture capital in India is still in infancy, being about a decade old. In fact, in India, risk financing is still in an evolutionary state. The funds available to the Indian venture capital industry are small. In developed countries, where there is a highly progressive industrial environment as well as an advanced entrepreneurial culture, it is common for entrepreneurs to set up companies to produce new products by obtaining funds from venture capitalists. On the other hand, in India and also in other developing countries, 'risk' financing of this type is yet in its infant stage. Of course, there are a large number of commercial banks and financial institutions in India which are providing funds to entrepreneurs.

Primary Sources of Venture Capital

- The private person having wealth.
- Pension Fund, trust, Insurance Company, banks, etc

Institutional Sources of Venture Capital

Following are the institutional sources of venture capital:

All India Financial Institutions

- Venture Capital division of Industrial Development Bank of India.
- Venture capital and technological Finance Corporation, a subsidiary company of Industrial Finance Corporation of India.
- Fund of 20 crores created jointly by industrial credit and Investment Corporation of India and Unit Trust of India.

By State Finance Corporation

- Venture capital Limited sponsored by Gujarat Finance Corporation (GVFL).
- Andhra Pradesh Industrial Development Corporation venture capital Limited (APIDC).

By Banks

- CAN Bank Venture Capital Fund have sponsored by CAN FIN and Canara Bank.
- SBI venture capital fund.
- The investment fund of India sponsored by Grindlays Bank.
- Infrastructure leasing sponsored by the Central Bank of India.

Private Sector Companies

- Indus venture capital fund sponsored by Mafat Lal and Hindustan Lever.
- 20th-century venture capital Corporation Limited.

- The venture capital fund is sponsored by V. V. Desai.

Other Sources of Venture Capital in India

In India, various other sources, in addition to the aforesaid sources also not only provide the venture capital but also provide several assistance and facilities, in the following forms:

Equality capital

This is the major source of venture capital. In India, most of the venture capital funds provide assistance in equity shares. But, the form of the type of assistance is not more than 49% of the total equity capital. It is to be remembered here that the objective of purchasing equity shares of any enterprise by a venture capital fund is to ultimately sell them for earning profits.

Conditional Debt

Such debt is reimbursable in the form of royalty when the project reaches the stage of making sales. Interest is not paid on such debt. The royalty of about 2 to 15 percent is charged by venture capital funds. In such types of sources, the alternative of payment of high interest is offered to the entrepreneur in comparison to some fund royalty, when the project becomes commercially perfectly sound.

Income Note

This is such a source of venture capital, in which the entrepreneur has to pay the royalty on sale also, along with interest. The funds are provided as unsecured interest in various development stages at 9% interest.

Establishment of Shares in the Market

This facility is provided to those small entrepreneurs, who cannot have access to the public for finances, due to the high cost of issue of shares and not having developed infrastructure. In India, such types of facilities are provided by the State Bank of India. These institutions purchase the shares of the Enterprises, after proper assessment, according to their laws, bye-laws, and guidelines of the Government of India, with the intention that when the company will reach the stage of profitability after 1-2 years, then it will have its own public issues.

Public Proposal in Phases

The government of India has provided this facility for companies running in profits. For that, arrangements are made to issue the share of profit-bearing companies to the public, in phases, so that the capital of people may reach the market. But, for such companies, it is compulsory to issue 60% shares at stock exchanges for listing.

Public Deposits

For the last few years, the importance of public deposit has been increasing in the corporate sector in India. So, the entrepreneurs may have financial arrangements for new projects. But the guidelines issued by the government will have to keep in view, so that the public may not be deceived.

Conclusion

Venture capital serves as a crucial catalyst for economic growth by providing funding to early-stage businesses with substantial growth potential. This form of financing, typically extended by venture capital firms or individual investors in exchange for equity, plays a pivotal role in nurturing innovation and entrepreneurship. By injecting capital, expertise, and networking opportunities into startups, venture capital fuels the development and commercialization of groundbreaking products and services. This not only drives job creation and fosters business expansion but also contributes to overall economic growth by fostering a dynamic ecosystem of innovation and investment.

* * * * * * * *