# Venture Capital in India : The Present and Future

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Venture Capital is money provided by an outside investor to finance a new, growing, or troubled business. The venture capitalist provides the funding knowing that there's a significant risk associated with the company's future profits and cash flow. Capital is invested in exchange for an equity stake in the business rather than given as a loan, and the investor hopes the investment will yield a better-than-average return.[1] Venture capital is an important source of funding for start-up and other companies that have a limited operating history and don't have access to capital markets. A venture capital firm (VC) typically looks for new and small business with a perceived long-term growth potential that will result in a large payout for investors. A venture capitalist is not necessarily just one wealthy financier. Most VCs are limited partnerships that have a fund of pooled investment capital with which to invest in a number of companies. They vary in size from firms that manage just a few million dollars worth of investments to much larger VCs that may have billions of dollars invested in companies all over the world. VCs may be a small group of investors or an affiliate or subsidiary of a large commercial bank, investment bank, or insurance company that makes investments on behalf chents of the parent company or outside investors. In any case, the VC aims to use its business knowledge, experience and expertise to fund and companies that will yield a substantial return on the VC's investment, generally within three to seven years. Not all VC investments pay off. The failure rate can be quite high, and in fact, any where from 20 percent to 90 percent of portfolio companies may fail to return on the VCs investment. On the other hand, if a VC does well, a fund can offer returns of 300 to 1,000 percent. In additional to a portion of the equity, a VC expects to have a say in how its portfolio company operates. Ideally, the VC fosters growth at the company through its involvement in managerial, strategic,

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and planning decisions. To do this, the VC relies on the expertise of its general partners who may be former CEOs, bankers, or experts in a particular industry.

In most cases, one or more general partners of the VC take Board of Director positions at a portfolio company. They may also help recruit key executives to the portfolio company. Not all VCs invest in 'start-ups'. While some may invest small amounts of "seed" capital for very early ventures, many focus on early or expansion funding, while still others may invest at the end of the business cycle, specializing in buyouts, turnarounds, or recapitalizations. VCs may be generalists that invest in a variety of industries and locations. More typically, they specialize in a particular industry. Venture capital is not an option for all new business. In fact, VCs are very selective in choosing new companies to invest in the company. They're most interested in business with high growth potential that will allow them to successfully exit with a higher than average return in a time frame of roughly three to 10 years, depending on the type of investment. Given the rigorous expectations, most venture funding goes to companies in rapidly expanding industries such as technology, biotechnology, and life sciences.

There are some excellent alternatives to venture capital that it should also explore in the search for funding sources. One such alternative is an **angle investor** - a term for an investor that takes under its wing and lifts up to the next level of growth. Angel investors typically do not have deep pockets so the average investment tends to be smaller than that of a VC, typically hundreds of thousands of dollars rather than millions. For that amount of capital, proceed with caution if considering giving up some control over your company. For instance, it may not be wise to give a Board position to an angel investor who does not necessarily have the time, experience or expertise to make a significant contribution to company. It might also consider a **strategic investor** partner in place of a VC investment. A strategic investor often has deeper pockets than an angel investor, but typically has a specific reason for investing in company. The investor may only want to leverage technology for its own purposes, which could have a negative impact on business. Or, the investor may want a licensing distribution agreement if the company succeeds, which could benefit the company.

Venture capital would over are going global and overseas investment is a known strategy. This is sustainable trend and is attributable to the proven high quality of Indian entrepreneurship both in India and aboard, the quality of manpower available in India with respect to IT and other technology areas such as biotech

and the amazing cues from the world, for instance the world is talking about bioinformatics and already a few entreneurs have started training institutes in India to train bioinformatics professionals.

It goes without saying that the dotcom ventures have taught a very good lesson. Venture capitalist world over have learnt that seeing busines in bubble is erroneous, instead they need to see a business in a business. Venture capitalist have realized that an entrepreneurial team needs to have a business model in addition to a fantabulous idea and more importantly the business model explicitly should emphasis a venture capitalists ability to meet adverse situation, for instance those which maintained high liquidity as a strategy survived the downturn, while others have down the drain So, now venture capitalists are not just looking for "Techy" ideas but also the business model. Their primary concern now is whether the venture can be exited in time i.e. its liquidity.

Government's policy was always slow to come in the case of venture Capital industry: Government should consider giving tax incentives to the investors of the venture funds and this would boost the investment in venture funds from domestic contributors. Securities Exchange Board of India (SEBI) should also consider giving a special treatment to initial public offering to the venture funds becuase venture capital funds have a serious problems in existing from their investment currently. They may also relax provisions concerning track recores of the company for a limited period. Department of company affairs should recongnize the newer forms of organization like limited partnerhsip and also make provision to recongnize sweat equity. To encourage the grwoth of Venture capitalists, laws related to compensation should also be reviewed.[2]

## The Funding Pricess

### Step 1. Business Plan Submisison

The first step in approaching a VC is to submit a business plan. At minimum, Plan Should include:

1. a description of the opportunity and market size;
2. resumes of the management team;
3. a review of the competitive landscape and solutions;
4. detailed financial projection; and
5. a capitalization table.

These also include an executive summary fo business proposal along with the business plan.

Once the VC has received plan, it will discuss opportunity internally and decide whether or not to proceed. This part of the process can take up to three weeks, depending on the number of business plans under review at any given time. Follow with the VC to check the statues of the proposal and to find out if there's additonal information could be providing that might help the VC with its decision. If it is asked for further informaiton, respond quickly and effectively. If possible, always try to get a face-to-face meeting with the VC. Most VCs receive an average of 200 business plans each month. Of those, less than five percent will be invited to meet with the VC's partners. Just two percent will reach the due deligence phase, and less than one percent will be offered a term sheet. Some 0.3 percent of those submitting a business planwill ultimately obtain VC funding. The overwhelming majority of successful proposals come from a trusted referral of the VC, such as a limited partner, another VC, a known attorney or accountant, or other porfessional.

**Step 2 : Introductory Conversation/Meeting**

If the firm has the potential to fit with the VC's investment preferences, it will be contacted in order to disucss business in more depth. If, after the phone conversaiton, a mutual fit is still seen, it will be asked to visit with the VC for a one- to two hour meeting to discuss the opportunity in more detail. after this meeting, the VC will determine whether or not move forward to the due diligence stage of the process.

**Step 3 : Due Diligence**

The due deligence phase will vary depending upon the nature of the business proposal. The process may last from three weeks to three months, and it should expect multiple phone calls, emails, management interviews, customer references, product and business strategy evaluations and other such exchanges of information during this time period.

**Step 4 : Term Sheets and Funding**

If the due deligence phase is satisfactory, the VC will offer a term sheet. This is a non-binding document that spells out the basic terms and conditions of the

investment agreement. The term sheet is generally negotiable and must be agreed upon by all parties, after which it should expect a wait of roughly three to four weeks for completion of legal documents and legal due diligence before funds are made available.

## Types of Funding

The forest professional investor to a deal at the start-up stage is referred to as the Series A investor. This investment is followed by middle and later stage funding - the Series B, C, and D rounds. The final rounds include late stage and pre-IPO funding. A VC may specialize in provide just one of these series of funding, or may offer funding for all stages of the business life cycle.

1. **Seed Capital.** If the company / firm just starting out and have no product or organized company yet, the company would be seeking seed capital. Few VCs fund at this stage and the amount invested would probably be small. Investment capital may be used to create a sample product, fund market research, or cover administrative set-up costs.

2. **Startup Capital.** At this stage, the company would have a sample product available with at least one principal working full-time. Funding at this stage is also rare. It tends to cover recruitment of other key management, additional market research, and finalizing of the product or service for introduciton to the marketplace.

3. **Early Stage Capital.** Two to three years into the venture, it is gotten company off the gound, a management team is in place, and sales are increasing. At this stage, VC funding could help the company increase sales to the break-even point, improve the productivity, or increase company's efficiency.

4. **Expansion.** At this stage company is well established, and now the company looking to a VC to help take business to the next level of growth. Funding at this stage may help in entering the new markts or increase marketing efforts.

5. **Late Stage Capital.** At this stage, the company has achieved impressive sales and revenue and have a second level of management in place. Company may be looking for funds to increase capacity, ramp up marketing, or increase working capital.

Company may also be looking for a aprtner to help find a merger or acquisition opportunity, or attract public financing through a stock offering. There are VCs

that focus on this end of the business spectrum, specializing in initial public offerings (IPOs), buyouts, or recapitalizations. A key factor for the VC will be risk versus return. The earlier a VC invests, the greater are the inherent risks and the longer is the time period until the VC's exit. It follows that the VC will expect a higher return for investing at this early stage, typically a 10 times multiple return in four to seven years. A later stage VC may be seeking a two to four times multiple return within two years.

## VC Exit Strategy

The exit stragety is the VC's way of cashing out on its investment in a portfolio company. A VC of ten hopes to sell its equity (stock, warrants, options, convertibles, etc.) in a portfolio company in three to seven years, ideally through an initial public offering (IPO) of the company. The company becomes liquid thorugh the sale of its stock to the public While an **IPO** may be the most visible and glamorous form of exit, it's not the most common. Most companies are sold through a **merger or acquisition** event before an IPO can occur. If the portfolio company is bought out or merges with another company, the VC receives stock or cash from the vent. Another alternative may be the reorganization or a portfolio companys' debt and equity mixture, called a **recapitalization.** The VC exchanges its equity for cash, the management team gains equity incentives, and the company is positioned for future grwoth.

## The Dual Dimenisons of Corporate VC

A corporate VC investment is defined by two characteristics: its objective and the degree to which the oprations of the investing company and the start-up are linked. Although companies typically have a range of objectives for their VC investments, this type of funding usually advances one of two fundamental goals. Some investments are straegic: They are made primarily to increase the sales and profits of the corporations own business. A company making a strategic ivnestment seeks to identify and exploit synergies between itslef and a new venture. For example, Lucent Venture partners, which invests the telecommunicaiton equipment makers funds in external companies, makes investments in start-ups that are focused on infrastructure or services for voice or data networks. Many of these companies have formal alliances with Lucent to help sell Lucents equipment alongside their own offerings. While Lucent would clearly like to make money on its investments

in these start-ups, its is willing to accept low returns if its own business perform better as a result of the investment.

The other investment objective is financial, wherein a company is mainly looking for attractive returns, here, a corporaiton seeks to do as well as or better than private VC investors, due to what it sees as its superior knowledge of markets and technologies, its strong balance sheet, and its ability to be a patient investor. In addition, a company's brand may signal the quality of the start-up to other investors and potential customers, ultimately returning rewares to the original investor. For example, Dell ventures, Dell Computers in-house VC operaiton, has made numerous Internet Investments that it has expected to earn attractive returns. While the company hopes that the investments will help its own business grow, the main rationale for the investment has been the possibility of high financial returns.

The second is defining characteristics of coporate VC investments is the degree to which companies in the investment portfolio are linked to the investing company's current operaitonal capabilities - that is, its resources and process. For example start - up with strong links to the investing company might make use of that company's manufacturing plants, distrubiution channels, technology, or brand. It might adopt the investing company's business practices its product.

**Four Ways to Invest**

Clearly, neither of these two dimensions of corporate investing-stratetic versus financial and tightly linked versus loosely linked - is an either - or proposition. Most investments will fall somewhere along a spectrum between the two poles of each pair of attributes. Still, overlaying the two dimensions creates a useful framework to help a company assess its current and potential VC investments.

**1. Driving Investments**

This type of investment is characterized by a strategic rationale and tight links between a start-up and the operaitons of the investing company. Although it's clear that many driving investment can advance a corporate strategy, there are limits to what they can achieve. The tight coupling of these investments with a company will sustain the current strategy. They will be unlikly to help a corporation cope with disruptive strategies or identify new opportunities when the company must go beyond its current capabilites to respond to a change in the environment. If a corporation wants to transcend current strategy and process, it should not rely on driving investents, which are ill suited for these tasks.

## 2. Enabling investmens

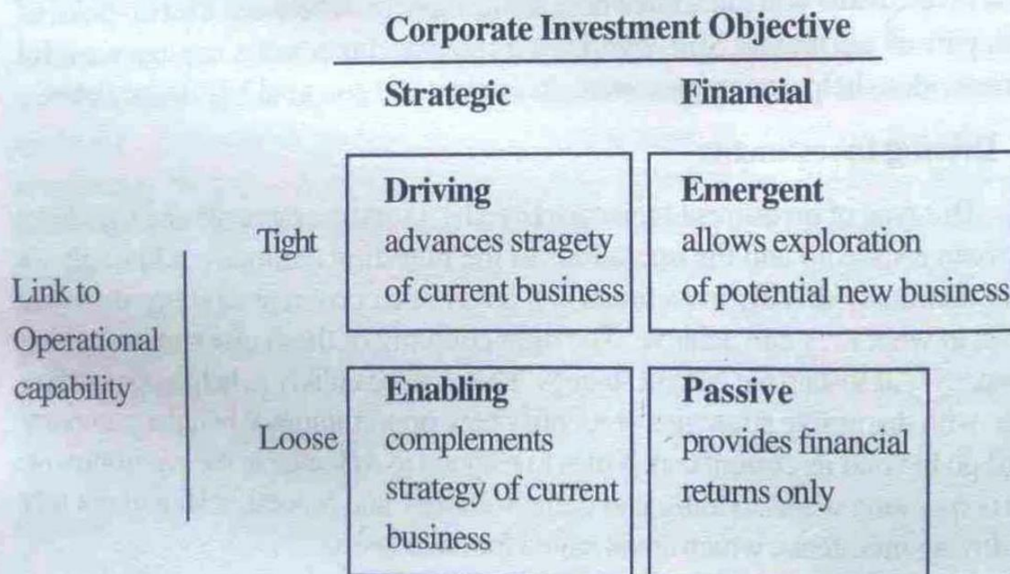
In this model of VC investing a company still makes investments primarily for strategic reason but does not couple the venture tightly with its own operations. The theory is that a successful investment will enable a company's own businesses to benefit but that a strong operational link between the startup and the company isn't necessary to realize that benefit. But enabling investment have their limits too. These vehicles will be justified only if they can capture a substaintial portion of the market growth they stimulate.

## 3. Emergent Investments

A company makes these kinds of ivnestments in start-ups that have tight links to its operationg capabilities but that offer little to enhance its current strategy. Nevertheless, if the business environment shifts or if a company's strategy changes, such a new venture might suddenly become strategically valuable. This give it an option like strategic upside beyond whatever financial returns it generates.

## 4. Passive Investments

In this model of VC investments, the ventures are not connected to the corporations own strategy and are only loosely linked to the corporations operational capabilities. consequently, the corporation lacks the means to actively advance its own business through these investments. And despite the perception of some companies that they enjoy technology or market knowledge that gives them advantages over other investors, the recent flight of corporate VC suggest otherwise.[3]



## Conclusion and Suggestions

As for venture capital, India has seen a boom with a strong start to 2008. In the second quarter of 2008, India attracted $ 238 million in venture capital investment, a 120% increase over an already impressive last year. Overall of 2007, venture capitalists invested $928 million in 80 deals in entrepreneurial companies based in India.[4] The lessons one needs to learn from the whole arguments is not rely on the government for everything and Indian venture capitalists need to understand that deals are not going to come to the place where they prefer to receive them i.e. in their offices; they have to build proper network with research them i.e. in their offices; they have to build proper network with research bodies and goal of creating entrepreneurial culture by promoting entrepreneurial forums in the location where they are situated. That is how quality deals flow to the extent can be ensured. Investment risk increase in unexpected proportions if venture capitalists back bad deal. Some of the criteria Indian venture capitalists back bad deals. Some of the criteria Indian Venture Capitalists are looking for includes experienced entrepreneurial teams who have demonstrated their abilities in the past. Though they need not be entrepreneurs in the past, they need to have a thorough familiarity with their proposed ventures.

As indicated above, policy initiatives for venture capital industry were always slow to come. Many of Chandrasekhar Committee Report suggestions are being considered. Considerable developments have taken place being treatment. But the much awaited tax incentives for investors in venture funds is yet considered. The legal environment needs to encourage limited liability partnerships. But these changes will surely follow. The future of venture capital companies is that they are going to be significant economic contributors and they are going to grow. But what venture capitalists needs to ponder over are networking and creation of entrepreneurial culture.

There is no one criterion to judge whether an investment strategy is "good" or bad. An investment strategy is the outcome of the fund objective as agreed by the fund investors. Each fund manager is based on the fund objective and investor requirements determines his strategy and whether the fund will make money depend on time and other factors. There should not be only one strategy since then there would be no market at all. By concepts, it is a report but currently the venture capital funds mainly comes from overseas, as there is no large domestic pool of

funds. We are a capital served country. So most of the money has to come from the international markets and for any fund collection, a conductive regulatory, tax and legal environment is important. There are a few legal issues, which have to be sorted out. These include investment in listed stock that is new issue of shares, investment by domestic investors in an offshore fund raised to invest in India or Indian connected companies and allowing domestic funds to hold shares inholding companies incorporated outside India with development efforts / back office in India.[5]

## References

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