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A STUDY OF ROLE OF VENTURE CAPITAL FINANCING IN THE GROWTH AND DEVELOPMENT OF STARTUPS IN INDIA

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ABTRACT

Venture capital financing firms have unique capabilities in terms of dealing with high uncertainty, high degrees of information asymmetry, and providing access to a strategic network in the setting up of Startups. This study examines the association between the presence of venture capital financing and the growth of startups. It explores whether venture capital leads to growth or, alternatively growth signals the need for venture capital funding. It also investigates the impact if any of venture capital financing events on startups and the growth of these firms. Finally, it documents the relationship between growth in startup financial valuation and changes in the number of employees over successive rounds of financing.

Most of the start ups in high technology companies have used venture capital funds in order to get started. The venture capital funds typically invest. Venture capital financing is "Equity support to fund new concepts that involve a higher risk and at the same time have a high growth and profit." Venture capital financing broadly implies an investment of long term, equity finance in high risk projects with high reward possibilities.

This study explores the concept of venture capital financing, its types, methods, procedure, stages, issues and regulations. The study also brings its connection with the startups and their

growth and development and role by the Venture Capital as a financial service provider to them.

Keywords: Venture capital financing, Start ups, Growth & Development

Introduction

Venture Capital financing refers to commitment of funding as shareholding for the formation and setting up of business units specializing in new ideas or new technologies also known as Startups. In simple words venture capital financing is the money or funds provided by the individual investors or entities seeking high return on their investments. In order to get the high returns, venture investors are ready to undertake or accept a high degree of loss of their investments. These organisation setups are also known as venture capital firm, venture capital fund, venture capital team, or simply venture capitalists.

These venture capital funds typically invest in business enterprises they anticipate being sold either to the public or to larger firms within the next few years of their start. Business enterprises venture capitalist considers in investing usually have the following features: -

- Rapid, steady sales growth,
- A proprietary new technology or dominant position in an emerging market,
- A sound management team,
- The potential for being acquired by a larger company or taken public in a stock offering.

Venture capital firms are primarily involved in financing new ventures. To deal with the high levels of uncertainty, risk, and information asymmetry, these firms heavily invest their own management talent into understanding the industry that they invest in, evaluating the prospects of the startups that they finance, coaching their management teams, and providing access to a network of external resources. The presence of venture capital financing is related to faster growth of the recipient industry. The timing of new funds from venture capital financing also has a significant impact on the growth of the firm. The startups increase their growth pace when they receive new funds. Even if the growth of startups may be related to different factors—internal as well as external—past growth captures the momentum that drives current growth. Finally, there is a positive association between headcount growth and changes in the valuation of startups over successive rounds of financing from Venture Capital.

Venture Capital Financing: Business requires capital and getting it at the right time is very important. There are several alternatives to fund the business. Few of them are mentioned as under

- Owner or Proprietor's Capital
- Equity Partner
- Debt Finance

This can further be branched to many options giving entrepreneurs several options to choose among. In this research paper the focus would be more on financing by Venture Capital which comes under equity financing and its role in the growth and development of Start ups.

Methods of Venture Capital financing

1) Equity
2) Conditional Loan
3) Income Note
4) Other Financing method

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 consists of the following: -

1. Financing new and rapidly growing projects, enterprises or companies.
2. Buying equity and other securities.
3. Taking high risk expecting high return on investment.
4. Having a long frame of time period, normally of more than 5 to 6 years.
5. Marketing and promotions of the product /service being offered.

In General, various types of investors such as corporate ventures, financial institutions, government institutions, corporate ventures, venture capital/ private equity firm and investment banks pool their money into venture capital fund and general partners manage their through investment in various growing companies to earn high rate return. In other words, venture capital funds act as financial intermediaries between investors and entrepreneurs. Investors supply funds as limited partners to Venture Capitalists and venture capitalists act as general partners while supplying funds to the entrepreneurs.

Venture Capital Financing Procedure

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:

Stages in Venture Capital financing procedure

1. **Pre seed Stage**: in this stage small amount of capital is provided to an entrepreneur to 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 break-even 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.
7. **Buyouts/Recapitalisation/Acquisition stage:** It is categorised into acquisition finance and management or leveraged buyout financing. Acquisition financing assists a company to acquire certain parts or an entire company. Management or leveraged buyout financing helps a particular management group to obtain a particular product of another company.

Issues and problems in Venture Capital Funding:

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 implications 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 reqiured 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;

- Requirement of an experienced managerial team.
- Requirement of high rate of return on investment.
- Payback period is normally long.
- Uncertainty regarding the success of the product in the market.
- Problems and issues regarding the infrastructure details of production like plant location, accessibility, relationship with the suppliers and creditors, transportation facilities, labour availability etc.
- The category of potential customers regarding products and service offerings.
- The size of the market.
- Major rivals and their market share.
- 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

Objectives: -

1. To know how Venture Capital financing plays an important role in the growth and development of Startups and provides support financially for the new ventures.
2. To understand the growth of new firms in the early stages of their lives and the role of venture capital firms as a source of financial resources on the growth of startups.
3. Whether the presence of venture capital financing is significant in explaining differences in growth rates across startups. Strong evidence is found that companies

with venture-capital financing grow faster over time than companies using other sources of financing.

4. Whether venture capitalists self-select investments in already growing firms or whether growth only arises after venture capitalists bring their financial and managerial resources.
5. It addresses links between the growth in the valuation of startups and headcount growth. Each new round of financing by a venture capital firm requires the startup be revaluated. It is found there is a significant positive relationship with changes in employee growth of the startup.

Hypothesis: -

1: Venture-backed startups grow faster than non-venture backed firms

2: Venture capital firms fund startups that have higher prior growth rates.

3: The timing of financing events affects the growth path of startups.

4: Employee growth in startups is associated with positive changes in firm value.

5: There is a positive relationship between Venture Capital and Growth of Startups.

Research Methodology

Research Methodology is a way to systematically solve the research problem. In it step by step methods are followed to solve a particular problem. It refers to search for knowledge. It can also be defined as a scientific and systematic search for pertinent information on a specific topic. The Study is carried out around different sources of data regarding venture capital finance and start ups in India. The data is collected by using different functions of Microsoft Office Word.

Data Collection

The study is based on the secondary data on Venture Capital and Start ups. The data is collected from various journals, web sites, online resources and other statutory bodies guidelines issued from time to time. The secondary data is also collected from various reference books on Venture Capital, Startups, Finance and Banking , Commerce Management etc.

For the said research study, the data pertaining to the above objectives was collected by the review of literature on the subject concerned. The literature was collected by visiting libraries and various concerned websites.

Research Design

Research design is the way in which the research is carried out. It works as a blueprint. Research design is the arrangement of conditions for the collection and analysis of data in a manner that aims to combine relevance to the research purpose with economy in procedure.

The research design for the current study is descriptive in nature. A descriptive design has been adopted to measure the impact of various dimensions of Venture Capital financing and its impact on the growth and development of Startups and their mutual give and take.

Limitations of Study

The study is based on the data provided by different sources, any incorrect or biasness in same might also have been resulted in same for this study.

Expected Contribution: -

Venture Capital Financing has become a part of the popular business in India. Venture Capital Investments are growing at an exponential rate and one who is starting or expanding his business can look at as a good option of financing its venture.

The following topics can be considered as the predictions of venture capital financing in India in startups.

- Existence of a international competitive high technology
- Initiatives taken by the Government in formulating policies to encourage investors and entrepreneurs.
- Initiatives of the SEBI to develop a strong and vibrant capital market giving the required liquidity and flexibility for investors for entry and exit

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, liberalising 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.

This research article contributes to the theory of the growth of the firm and shows how financing decisions affect the early phases of a startup. While the empirical results are informative to the literature and to practitioners, they also open several research opportunities to improve our understanding of the role of venture capital financing and the growth of the Startups firms.

On the basis of the research it seems evident that the strategy approach to the venture capital finance is essential. The key elements scope, synergy, competitive advantage and economic performance are most relevant issues in this approach. In the venture capital finance it is important to recognize strategic elements, which lay the basis for the success of the selected company. The decision of the scope of the Venture Capital fund is also relevant, because it guidelines the allocation of selection.

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