Venture Capital

Prof. Basavaprabhu Jirli
Director

Centre for Multi-Disciplinary Development Research (CMDR)
(An ICSSR Institute)
Dr. Ambedkar Nagar, Dharwad-580004
Karnataka www.cmdr.ac.in

What is Venture Capital?

- Private or institutional investment (capital) in relatively early-stage companies (ventures)
- Recent focus on technology-heavy companies:
  - Computer and network technology
  - Telecommunications technology
  - Biotechnology

The SEBI has defined Venture Capital Fund in its Regulation 1996 as

‘a fund established in the form of a company or trust which raises money through loans, donations, issue of securities or units as the case may be and makes or proposes to make investments in accordance with the regulations’.

Meaning

- Venture capital means funds made available for startup firms and small businesses with exceptional growth potential.

- Venture capital is money provided by professionals who alongside management invest in young, rapidly growing companies that have the potential to develop into significant economic contributors.

Types of VCs

– Angel investors

– Financial VCs

– Strategic VCs

Angel Investors

- Typically a wealthy individual
- Often with a tech industry background, in position to judge high-risk investments
- Usually a small investment (< $1M) in a very early-stage company (demo, 2-3 employees)
- Motivation:
  - Dramatic return on investment via exit or liquidity event:
    - Initial Public Offering (IPO) of company
    - Subsequent financing rounds
  - Interest in technology and industry

Financial VCs

- Most common type of VC
- An investment firm, capital raised from institutions and individuals
- Often organized as formal VC funds, with limits on size, lifetime and exits
- Sometimes organized as a holding company
- Fund compensation: carried interest
- Holding company compensation: IPO
- Fund sizes: ~$25M to 10's of billions
- Motivation:
  - Purely financial: maximize return on investment
  - IPOs, Mergers and Acquisitions (M&A)

Strategic VCs

- Typically a (small) division of a large technology company
- Corporate funding for strategic investment
- Help companies whose success may spur revenue growth of VC corporation
- Not exclusively or primarily concerned with return on investment
- May provide investees with valuable connections and partnerships
- Typically take a “back seat” role in funding

Advantages

- It injects long term equity finance which provides a solid capital base for future growth.

- The venture capitalist is a business partner, sharing both the risks and rewards.

- The venture capitalist is able to provide practical advice and assistance to the company based on past experience with other companies which were in similar situations.

Advantages (Cont.)

- The venture capitalist also has a network of contacts in many areas that can add value to the company.

- The venture capitalist may be capable of providing additional rounds of funding should it be required to finance growth.

- Venture capitalists are experienced in the process of preparing a company for an initial public offering (IPO) of its shares onto the stock exchanges or overseas stock exchange such as NASDAQ.
- They can also facilitate a trade sale.

Stages of financing

1. Seed Money:

   Low level financing needed to prove a new idea.

2. Start-up:

   Early stage firms that need funding for expenses associated with marketing and product development.

3. First-Round:

   Early sales and manufacturing funds.

4. Second-Round:

   Working capital for early stage companies that are selling product, but not yet turning a profit .

5. Third-Round:

   Also called Mezzanine financing, this is expansion money for a newly profitable company

6. Fourth-Round:

   Also called bridge financing, it is intended to finance the "going public" process

Risk in each stage

Financial Stage	Period (Funds locked in years)	Risk Perception	Activity to be financed
Seed Money	7-10	Extreme	For supporting a concept or idea or R&D for product development
Start Up	5-9	Very High	Initializing operations or developing prototypes
First Stage	3-7	High	Start commercials production and marketing

Financial Stage	Period (Funds locked in years)	Risk Perception	Activity to be financed
Second Stage	3-5	Sufficiently high	Expand market and growing working capital need
Third Stage	1-3	Medium	Market expansion, acquisition & product development for profit making company
Fourth Stage	1-3	Low	Facilitating public issue

Venture capital funds in India

- The concept of venture capital was formally introduced in India in 1987 by IDBI.

- The government levied a 5 per cent cess on all know-how import payments to create the venture fund.

- ICICI started VC activity in the same year

- Later on ICICI floated a separate VC company - TDICI

VCFs in India categorized in 5 groups:

1) Those promoted by the Central Government controlled development finance institutions. For example:
   - ICICI Venture Funds Ltd.
   - IFCI Venture Capital Funds Ltd (IVCF)
   - SIDBI Venture Capital Ltd (SVCL)

2) Those promoted by State Government controlled development finance institutions.
For example:
- Punjab Infotech Venture Fund
- Gujarat Venture Finance Ltd (GVFL)
- Kerala Venture Capital Fund Pvt Ltd.

3) Those promoted by public banks.
For example:
- Canbank Venture Capital Fund
- SBI Capital Market Ltd

4) Those promoted by private sector companies.

For example:

- IL&FS Trust Company Ltd
- Infinity Venture India Fund

5) Those established as an overseas venture capital fund.

For example:

- Walden International Investment Group
- HSBC Private Equity management Mauritius Ltd