Business Communication and SWOT Analysis for an Entrepreneur

W4L1- Venture Capital

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Hello, friends. In today's class, we will be looking into the concept of venture capital. Basically, venture capital is an arrangement for organizing the finance for an innovative idea, what kind of opportunities that you will get, as far as arranging the finance that will be looking into detail.

Basically, this is a private or institutional investment in relatively early stage company, which we call as venture when an early stage enterprise is in need of finance, an innovative idea is in need of finance, which is not established in the market, but given an opportunity, it can prove its worth, if any such ideas are there. So these venture capitalists are in search of such ideas and innovative professionals so that they can make it a reality over a period of time. The recent focus on the technology heavy companies like the computer and network technologies, telecommunication technologies and the biotechnologies are the more focus areas for this venture capital. But it is not limited to only these areas which are listed here, any innovative idea which has the potential of ensuring the highest amounts of profit can be covered under this nature of funding when we come to its definition of the venture capital. SEBI, in 1996 defined venture capital as a fund established in the form of a company or trust which raises money through loans, donations, issues of securities or units, as the case may be, and makes or proposes to make investments in accordance with the regulations, is classified under venture capital. It means so it may be a trust, or it may be a company which can provide you the funding by raising money in the form of loan or donation or any form that you can.

Then basically it is focusing on the industries which are having exceptional growth potential. So this is what is the prerequisite for getting finance under venture capital scheme. The idea should have exceptional growth potential. So there, it can be classified into three distinct groups the nature of this venture capitals. The first one is the angel investors, second one is the financial venture capitalist, and the third one is the strategic venture capitalist. So let us begin with the angel investors. Who are these angel investors? They are typically a wealthy individual who is unable to take up the venture for many personal reasons, but he has huge amount of money for the purpose of investment. So often they are in search of the industries with technology background, and they themselves are in a position to judge the high risk investments, because they can exploit the best possible benefits out of these ventures. The range of this angel investors usually less than 1 million US dollars in a very early stage company with maybe two or three employees or the demo type of things.

The motivation behind this angel investors is dramatic return on the investment via exit or liquidity, they may collect money from IPOs of the company, and subsequent rounds of financing, then interest in the technology as well as industry that they are having. So these are the basic ideas behind this venture capitals, and it is an individual many times we come across the cases that the family members themselves act as an angel investors. Maybe it is your direct relatives or distant relatives who come forward to finance the idea that you are having then coming to the financial capitals, the this is the most common type of venture capital available in the market. It is basically an investment firm which raises the capital from institutions and individuals, often organized as a formal venture capital funds with limits on the size and exits and entry point and all these things. They have sets of rules and regulations.

Sometime they organized as a holding company also then the fund compensation. It carried the interest, and they can raise the money with the IPOs. The fund size varies from $25 million to 10s of billions of dollars that you can think of. The motivation behind this financial venture capitalist is purely financial in nature. They want to invest money, and they want to earn money by investing money. So this is, what is the basic idea behind this type of companies that what we can say then coming to the strategic venture capitalist. They are typically a small division of a large company, and they provide funding for the strategic investment what is possible in future, because among their employees, so there are few individuals who are having some innovative ideas which have the exponential business potential in a future, such ideas that they will be searching for, and they help companies whose success may spur revenue growth out of this Venture Capital Corporation, not exclusively or primarily concerned with the return on investment, because they want to experiment with this, and that is how they are investing money on the ideas of few individuals, it may provide investees with a valuable connections and partnership because the company itself is established.

The organization itself is established, and they have their own experience and expertise in that particular area, and typically they take a back seat while funding this particular area, because they make that particular individual a face for organizing this venture capital. The advantages of this venture capital includes, it injects the long term equity finance, which provides a solid capital base for the future growth. The individual who is working on his idea, he need not worry about the financial resources as well as the expertise available with him, because there are a group of people or an individual or institution as a venture capitalist is supporting him so that he can focus on his ideas.

The venture capital is basically a business partner sharing both risk as well as rewards. Even if there is loss, that venture capitalist ready to bear that, and whenever there is reward, they are going to have their own sharing formulas. The venture capitalist is able to provide the practical advice with his own experience and various forms of assistance to the organization or the company that you are launching based on his previous expertise and the companies which are in similar situations. So this is what is the best part of venture capitalist that what we can say, because traditionally, if we approach the, you know, the financial institution like the may be commercial bank or a private bank, they may not be able to provide these aspects, what the venture capitalist are providing. Then the venture capitalist has a network of contracts in many areas that can add value to the company or the idea that you are working on, the venture capitalist, he may be capable of providing additional rounds of finances, whatever is required for growth of that particular organization, or the idea, because their basic expertise is providing the finance, and they can also facilitate the trade, as well as the sale of the products what you are coming out with.

Then there are different stages of financing. This is very important to understand. The seed money, the low level of financing is needed to prove a new idea. The first level that what we can say, then the second stage is start up. The early stage firms that need funding for expenses associated with marketing and the product development. Once your idea has some potential. So then they will provide you the second round of finance. Then the third level is the first round of finance, early sales and manufacturing funds, because you have made the prototype. Now it needs to be taken to the market to look into the reactions of the end users. Then the second round of finance depends on the first round. That is, what is the fourth stage working capital for early companies that are selling the products, but not at turning a profit. It means there is time to reach the breakeven point. But you are making the promising progress in this particular area.

So then you are eligible for second round of finance. Then the third round, it is also called as the mezzanine financing. So it is basically to expand. the existing idea to different parts of the state or different corners of the country. And in some cases, it may be in different countries. So, because the company has the idea that is worth expanding and it can give them the exponential benefits in the days to come.

The fourth round, which we call it as a bridge financing, it is intended to going to the public process so that you are inviting many partners into your, business activities or the ideas. Now, let us compare these things with the risks in each and every stage. The first stage, that what we discussed about the seed money. The period of funding is available for 7 to 10 years that what we can say. The perceived risk is to the highest level, what we say that it is extreme in nature. So, which are financed in the seed money stage is supporting the concept or the idea or the research and development process for development of a sellable product or a service. The second round of finance, what we discussed, that is startup. So in the next five to nine years, the risk is very high. So here we'll be initializing the operations and developing the prototypes. And the first stage begins with the actual product as well as service and taking it to the market which wherein we enter into the first stage, which is of about 3 to 7 years of period. Then the risk here is relatively high, but compared to the seed minion startup, it is relatively less because we are starting with the commercial production as well as marketing and we start getting the returns out of that also.

The fourth stage is the second stage of finance, which the period is around 3 to 5 years because you are slowly proving your worth of your product and people are purchasing that and there are results. The perceived risk is relatively high here. But the activities that are financed here is for expansion of the market and growing working capital and all those things are met at this particular stage.The at the third stage, it is now you can see that the period is reducing over a period of time. It is now one to three years. The perceived risk is minimum because you are expanding the market. You can acquire many various other similar products as well as services. You can think of product development for profit making.

etcetera, etcetera are added at this particular stage. And the fourth stage again, it is taking about 1 to 3 years, wherein the perceived risks are very, very low, because you are facilitating the public issues also and you, you have established yourself into the market. So, these are the different stages at which the venture capital funds are being provided.

Now, we will be discussing some examples. under each category which are the institutions which are providing the venture capital funds for the potential entrepreneurs. The concept of venture capital was formally introduced in India in the year 1987 by IDBI, Industrial Development Bank of India. The government has levied a 5 percent on all know how import payments to create this particular venture capital fund with which they were supporting such innovative ideas. Then in the same year, ICICI, which is a private bank, also started with the venture capital activity in the year. Then later, ICICI floated the separate venture capital fund company known as TDICI. Now, the venture capital funding agencies can be classified into five groups in the Indian context. So, I will be taking them one by one.

First one, those companies which are promoted by the central government controlled development financial institutions. For example, ICICI, it is controlled by the central government, IFCI, Venture Capital Funds, it is also controlled by the government, SIDBI, which is popularly known as Small Industrial Development Bank of India. So, they have their own venture capital initiatives. All these things are controlled by the central government. The second group is the group of companies promoted by the state government and controlled by the state government. For example, Punjab Infotech Venture Fund, Gujarat Venture Finance

Limited, Kerala Venture Capital Fund, Private Limited, all these are controlled by the state government.

Now, the third category is those promoted by the public banks. For example, Canara Bank Venture Capital Fund, SBI Capital Market Fund, like that, all these Almost all public sector banks are having their own venture capital funds. This is only an indicative list. Then those promoted by the private sector companies, because the most successful private sector companies are also ready to invest on the innovative ideas by various individuals as well as institutions. IL&FS, Trust Company Limited, Infinity Venture India, so there are many such. So, in my next class, I will be focusing on the venture capital funds available for agriculture in government as well as in private sector separately. This is an indicative list and how this classification is there. Then the fifth category is, those companies established as an overseas venture capital funds. For example, Walden International Investment Group, HSBC Private Equity and these are some of the examples of the overseas venture capital funds. So under these five categories, venture capital funds are available.

So far, what we discussed. We discussed about the basic concept of venture capital, why and how this venture capital is being promoted and what are the different stages at which the venture capital funds are being provided and what is the risk involved and what are the different stages at which the funds are being provided and different venture capital funds that are available under different sector, maybe it is government sector, private sector and the state supported all these things that what we discussed.

And in my next class, I will be discussing about the venture capital funds available for agriculture in as a part of the government initiative and as a part of the private sector. Private initiative also.

Thank you.