VENTURE CAPITAL FINANCING: ISSUES AND CHALLENGES IN INDIA

[1]Mr. Firdous Ahmad Qazi, [2] Dr. Javed Iqbal.3 Azra Mufti
[1]Research Scholar. [2]Assistant Processor,Research Scholar
School of Management Studies.
BGSBU, Rajouri, J&K.

ABSTRACT

In a developing economy like India, we see mushrooming growth of fast growing companies that can be of significant importance but lack finances to do so, venture capital is thus a life saving concept that provides money to professionals to invest in these companies. Money can be raised through loans, issuing securities or donations. In India, it is still in inception phase, there is a strenuous global pressure on competitive and technological fronts. With venture capital, the venture capital firm gives funding to the startup company in exchange for equity in the startup. This is most commonly found in high growth technology industries like biotech and software. A person who deals in venture capital is a venture capitalist, and usually works for a venture capital firm. The firm typically has one or more investment portfolios that are owned by a limited partnership. The venture capitalist is often a general partner in the portfolio, and individual investors or other institutions particularly university endowments and pension funds are limited partners in the limited partnership This paper tries to identify the issues and challenges of venture capital financing in India and the opportunities that follow.

Keywords: **Venture Capital Financing, securities, challenges.**

INTRODUCTION

Securities Exchange Board of India (SEBI) defines venture capital financing as a fund that is established in a form of trust, the money can be raised through options like selling securities, taking loans or asking for donations. The money that is raised via these funds is used in highly profitable and potential business proposals that operate at a higher risk or loss. The person who raises money is called venture capitalist and he provides assistance, expertise, support and networking for prospective business ideas. The capitalist is responsible for financing new and potentially viable companies and is ready to face risk also. His job is to provide technical assistance, marketing assistance and overall functioning of the project. When a venture capitalist comes across a business idea that seems to be globally competitive or technically viable, he can think of investing in that project. Money can be raised from either public or private establishments in the form of equity or debt or a mixture of both. After liberalization policies of 1991, there has been a significant growth in economy; venture capital norms also changed which lead to entrepreneurship development. There has been a paradigm shift in the number of venture capital firms since 1991. It is interesting to note that successful firms like Intel, Oracle, Cisco and Skype were first funded by venture capital firms. This trend has also started in India where venture capital has contributed in IT sectors.

RESEARCH OBJECTIVES

1. To understand the venture capital financing in detail
2. To understand the issues and challenges of venture capital financing in India
3. To understand the opportunities ahead for venture capital financing India

BASIC UNDERSTANDING OF VENTURE CAPITAL FINANCING

Venture capital financing developed in late twentieth century in USA, it started to gain popularity in late 1970's.The first venture capital organization was The American Research and Development and it paved way for financing of over 100 companies. The funding process takes in four steps which starts from idea generation; start up, ramp up and then ends with exit.

- **Idea Generation**: the process of venture capital financing starts by a proposed business plan. The plan should have a brief summary, the potential of business, financial feasibility and other related details. The team analyses the ideas and accepts the plan.
- **Meeting at initial stage**: once a plan is finalized, a meeting of all the required stakeholders is conducted to determine the future course of action.
- **Strategizing**: this aims at forming strategies to counter customer complaints, forming strategies and information exchange.
- **Term sheet**: Term sheet explains the basic terms and conditions between all the stakeholders.

The financing is done at three stages

- **Early Stage Financing:** it starts as seed financing, start up financing and first stage financing. Seed financing is defined as that amount which is provided for being eligible for loans. After this, start up financing is given for developing services, plans and products. Then comes the actual first stage financing that provides finance for all the major activities of the business.
- **Expansion Financing:** when companies do well in their initial stages, then the next step is to expand. This financing is provided to branch out and find new business opportunities to gain maximum benefits.
- **Buyout Financing:** this is providing financing for buying a part of company or entire company.

There are some advantages of venture capital financing in terms of profit. It can bring money to the company; they provide equity options to the company in addition to the technical and marketing assistance. But it has certain disadvantages too, the fact that complete autonomy is lost if we make others party to our business, decision making has to be compromised. Venture capital financing is an unpredictable source of financing and mostly it provides benefits for long run only.

ISSUES AND CHALLENGES OF VCF IN INDIA

- **Issues Related To Regulatory Framework**: India till date lacks a proper account convertibility framework; we face issue of share pricing, cap value and floor pricing which makes the whole procedure cumbersome.
- **Lengthy Allotment Process**: there exist some procedures where agreements between parties should be finalized which make the whole procedure tiresome; there should be some regulations to loosen these regulations.
- **Expert management**: the process of VCF requires a team of experts who can value each aspect; it adds to the cost of companies and also sometimes leads to manual faults.
- **Long term gains**: Indians by nature are profit seeking, they want immediate results which is not the case in venture financing, it has a longer pay back time and takes it due time.
- **Market size**: the potent target for VCF is small yet, it cannot target to major customers as of now.
- **Mismatch of demand and supply**: there is a serious mismatch between what Indian market demands and what it gets. Some new growing companies look out for venture financing but are not technically sound. Sometimes they want exits from VCF which the regulations do not provide.

- **International competition**: international funds occupy a huge place in Indian markets. These global markets often tend to ignore the local needs. This thing should be addressed and more dependence should be placed on domestic firms.
- **Poor quality governance**: quality concern is one of the major issues of any firms. The legal redressal system in India is very weak and it takes a lot of time to get justice.
- **A need based trade association**: what matters at the end of the day is a broad based trade organization; it can bring humongous changes in entrepreneurial climate of country.

OPPORTUNITIES FOR VCF IN INDIA

The government is promoting growth in capacity utilization of available and acquired resources and hence entrepreneurship development, by liberalizing norms regarding venture capital. While only eight domestic venture capital funds were registered with SEBI during 1996-1998, 14 funds have already been registered in 1999-2000. Institutional interest is growing and foreign venture investments are also on the rise. Many state governments have also set up venture capital funds for the IT sector in partnership with the local state financial institutions and SIDBI. These include Andhra Paradesh, Karnataka, Delhi, Kerala and Tamil Nadu. The other states are to follow soon. In the year 2000, the finance ministry announced the liberalization of tax treatment for venture capital funds to promote them & to increase job creation. This is expected to give a strong boost to the non resident Indians located in the Silicon Valley and elsewhere to invest some of their capital, knowledge and enterprise in these ventures. A Bangalore based media company, Graycell Ltd., has recently obtained VC investment totaling about $ 1.7 mn. The company would be creating and marketing branded web based consumer products in the near future. 10 - 12 years. The personnel behind these cabins should be experts to take their business to higher levels.

1. A need based research should be carried on ongoing firms in India and their lacunae should be filled by building stronger firms.
2. Government should form regulations to encourage new businesses and ideas.
3. Stronger grievance redressal system should be introduced.
4. Initiatives taken by the Government in formulating policies to encourage investors and entrepreneurs.
5. Vast pool of existing and ongoing scientific and technical research carried by large number of research laboratories
6. . The credit can be given to setting up of a National Venture Capital Fund for the Software and I.T. Industry (NFSIT) in association with various financial institutions of Small Industries and Development.

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