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"Venture Capital financing in India and growth of start-ups.".

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Abstract:

This paper gives an overview of venture capital (VC) funding in India and the growth of startups. Venture capital is a form of financing that investors provide to start-ups and small businesses that are considered to have high growth potential. In India, the venture capital industry has been growing steadily in recent years, with more and more start-ups and small businesses receiving funding from VCs.An important element fueling venture capital financing in India is that investors are becoming bolder in their pursuit of high-risk/high-reward opportunities in small to medium-sized enterprises with significant growth potential.

Keywords:

Venture capital financing, startups, stages, practices.

Introduction:

Venture capital (VC) is a form of private equity and a type of financing that investors provide to start-up companies and small businesses that are believed to have long-term growth potential. Venture capital generally comes from well-off investors, investment banks, and any other financial institutions. However, it does not always take a monetary form; it can also be provided in the form of technical or managerial expertise. Venture capital is typically allocated to small companies with exceptional growth potential, or to companies that have grown quickly and appear poised to continue to expand. Though it can be risky for investors who put up funds, the potential for above-average returns is an attractive payoff. For new companies or ventures that have a limited operating history, venture capital is increasingly becoming a popular even essential source for raising money, especially if they lack access to capital markets, bank loans, or other debt instruments. According to Schwienbacher (2007), start-ups that are highly profitable or have the potential to be, contacting Venture Capitalists is a better option than merely growing organically. However, when a venture capitalist-firm chooses to invest in a start-up it assumes great risks since creating a new business organization start-up involves considerable uncertainty.

Every start-up, irrespective of the nature and size of operations, requires funds to convert its innovative ideas into reality. Most of the businesses generally fail because of their inability to raise sufficient funds. After all, you need some money or capital to keep your business going at every stage. There are different ways and stages for raising capital.Based on the requirement and life cycle of business funding is been raised by start-ups.Venture capital firms based on the valuation of start-up takes decision on what amount needs to be invested and what returns are to be expected from the start-ups.

Importance of VC financingand growth of startups:

According to Team Inc 42, The year 2021 has been a landmark year for venture capital funding in India. The total funding raised by Indian startups in 2021 has been at a record level of $42 Bn across 1,583 deals. VC funding enables startups with expansion to other markets (cities, countries) and differentiation or diversification of product lines depending on the current stage of the business and more. The venture capital business in India is growing. The slow and arduous evolution of India's integrated venture capital sector has been constrained by resource constraints imposed by the overarching framework of socialistic economic ideologies. While banks and government-owned development finance institutions provided funding for new businesses, it was only available as collateral-based money on a project-financing basis, making it difficult for most new entrepreneurs, particularly those in the technology and services sectors, to raise funds for their ideas and businesses.

The scale and efficiency of business firms in India have grown. With rising overseas competition, venture capital may help a range of growth-oriented enterprises. Businesses in India that deal with computer technology, manufacture products, or provide contemporary facilities are eligible for venture capital investment. While its impact varies by region, the venture capital (VC) business is crucial in encouraging entrepreneurship and innovation.

In India, anybody with a creative company idea with expanding demand, a competent management team, an ambitious business model, and home-run potential can apply for investment capital funding. When they identify a business that satisfies all of the investment requirements, venture capitalists seize the opportunity to fund it in the hopes of generating a significant profit.

Venture capital financing is funding provided to companies and entrepreneurs. It can be provided at different stages of their evolution, although it often involves early and seed round funding.

Venture capital funds manage pooled investments in high-growth opportunities in start-ups and other early-stage firms and are typically only open to accredited investors.

Venture capital has evolved from a niche activity into a sophisticated industry with multiple players that play an important role in spurring innovation.

Thebenefits ofVenture Capital Financingfor Start-up's:

- Opportunity for expansion of the company
- Valuable guidance and expertise
- Helpful in building networks and connections

Objective:

The aim behind this study is-

1. To understand the role of venture capital financing practices on growth of start-up firms.
2. To study how start-up firms raise capital across their life-cycle.

Literature Review:

1) **Ahmed Idi Kato academy of Entrepreneurship Journal** 27(1):1528-2686-27-1-457 in his article "A literature review of venture capital financing and growth of smes in emerging economies and an agenda for future research" says that In spite of the dominance of the SMEs sector in emerging economies, access to sustainable financing for SMEs ' survival and growth, remains small and fragmented. There is a general consensus that VC is the most suitable funding model to revive the growth of the early-stage ventures. However, the fundamental impact of VC financing on the growth of the small-medium enterprises especially in the emerging economies has been under researched.This paper documents the relatively under-explored research areas and presents an agenda for future research in emerging economies. Contribution/value-add: The paper presents valuable knowledge to policymakers and practitioners to assist in the design of appropriate policies in support of easy access to VC financing by SMEs for their growth.

2)**Saranya KCG College of Technology** October 2019 International Journal of Engineering and Management Research 09(05):32-38 In her paper titled "A Comprehensive Study on Venture Capital Investments in India". Venture capital investments is India has been a buzzword over last five years. Venture capital investments have been considered as alternative financing sources for entrepreneurs. Venture capital has been established as "risk finance provided for the promotion of novice business ideas "across the globe. However, the pattern of venture capital investments across globe is dissimilar and concentrated in few regions. Concentration of venture capital investments is found to be influenced by geographic specific factors. Venture capital industry in India is in the growth stage and has witnessed tremendous growth in the last five to eight years. Itis crucial to trace the venture capital investment pattern of the nurturing venture capital industry like in India to assess the area of interest of investments and potential arena of venture capital investments.

3)**Vaishali Pagaria (2016)** brings in the conceptual insights of venture capital financing. Venture capital is considered as alternative source of financing for potential new generation ventures in India. The study states that Venture capital as risk financing which provides financial assistance to high growth potential and innovative business with risk. This characteristic differentiates venture capital from traditional sources of finances.

4) **Yuk-Shee Chan (2018)** assesses the role of venture capital as a financial intermediary. According to the developed theory of financial intermediation, venture capitalist acts as informed agents with imperfect information in a market. Entrepreneurs are the well informed about the qualitative prospects about the project. Entrepreneurs try to push the ventures with lesser prospects of survival and profitability. This forms a hindrance for the venture capital investments as it leads undesirable allocation of funds in low return projects.

5) **Dr. Mamata Jain and Ms. Purva Jain (2017)** Crucially analyze venture capital industry across the globe. The presence of well-established venture capital industry is witnessed in USA and Europe. Venture capital industry has played a prominent role in growth and expansion of business in these regions. Venture capital has been an engine for industrial development, especially knowledge-based industries by exploiting untapped potentialities. Major developments in venture capital industry in India are witnessed in during last five to seven years.

6) **Irena Dalic et al. (2017**) analyzed the role of venture capital in development of Small, Medium Enterprises. Venture capital investments have been source of finance for the early-stage ventures and industries with rapid growth opportunities. Venture capital

investors provide support for business activities. SMEs are the prime contributor for the employment creation and economic development. Venture capital is supporting the developing the growth of SME and jointly contributing to the national development.

Impact of venture capitalpractices on the startups

- **Dynamic Value**: Venture capital has opened up the arena of financing to smaller and medium sized firms all over the world. Venture capital funding brings in dynamic edge to how to promote yourself in fast paced world. It is indispensable nowadays. Understanding how modern age financing benefits the new start-ups is essential as it will help the businesses to utilize it more efficiently and effectively.
- **Business expertise**: Aside from the financial backing, obtaining venture capital financing can provide a start-up or young business with a valuable source of guidance and consultation. This can help with a variety of business decisions, including financial management and human resource management. Making better decisions in these key areas can be vitally important as your business grows.
- **Additional resources**: In a number of critical areas, including legal, tax and personnel matters, a VC firm can provide active support, all the more important at a key stage in the growth of a young company. Faster growth and greater success are two potential key benefits.
- **Connections**: Venture capitalists are typically well connected in the business community. Tapping into these connections could have tremendous benefits.

Stages for raising capital for start-ups across their life cycle:

There are five common stages of venture capital financing for start-ups to raise fund:

1. Pre-seed funding | Concept stage
2. Seed stage
3. Post-seed / pre-third stage | Bridge round
4. Third stage | Series A
5. Fourth stage | Series B
6. Pre-initial public offering (IPO) stage

1.Pre-seed funding: Before accessing VC capital, there is the pre-seed or bootstrapping stage. This is the time you spend getting your operations off the ground, and when you begin to build your product or service prototype to assess the viability of your idea. At this point it is unlikely that VCs will provide funding in exchange for equity, so you need to depend on your personal resources and contacts to launch your startup.

2.Seed stage: Your company now has a degree of experience and can demonstrate potential to develop into a vibrant company. You now need a pitch deck to demonstrate to VCs that your idea is a viable investment opportunity. Most of the modest sums you raise in the seed stage are for specific activities like:
Market research

- Business plan development
- Setting up a management team
- Product development

3.Post seed: The post-seed round is non-trivially bigger. A real post-seed round is the final seed money before a "super-sized" Series A round. Post-seed companies have product-market fit. They need money for sales and marketing, not a makeover.

4.Third stage/Series A: Series A typically is the first round of venture capital financing. At this stage, your company has usually completed its business plan and has a pitch deck emphasizing product-market fit. You are honing the product and establishing a customer base, ramping up marketing and advertising, and you can demonstrate consistent revenue flow.

5.Fourth stage/Series B: Your company is now ready to scale. This stage of venture capital supports actual product manufacturing, marketing and sales operations. To expand, you'll likely need a much larger capital investment than earlier ones. Series B funding differs from Series A. Whereas Series A investors will measure your potential, for Series B they want to see actual performance and evidence of a commercially viable product or service to support future fundraising. Performance metrics give investors' confidence that you and your team can achieve success at a larger scale.

6.Pre-initial stage: After reaching this juncture, the company may be looking to go public, given that its products and services have found suitable traction. Funds received here can be used for activities such as:

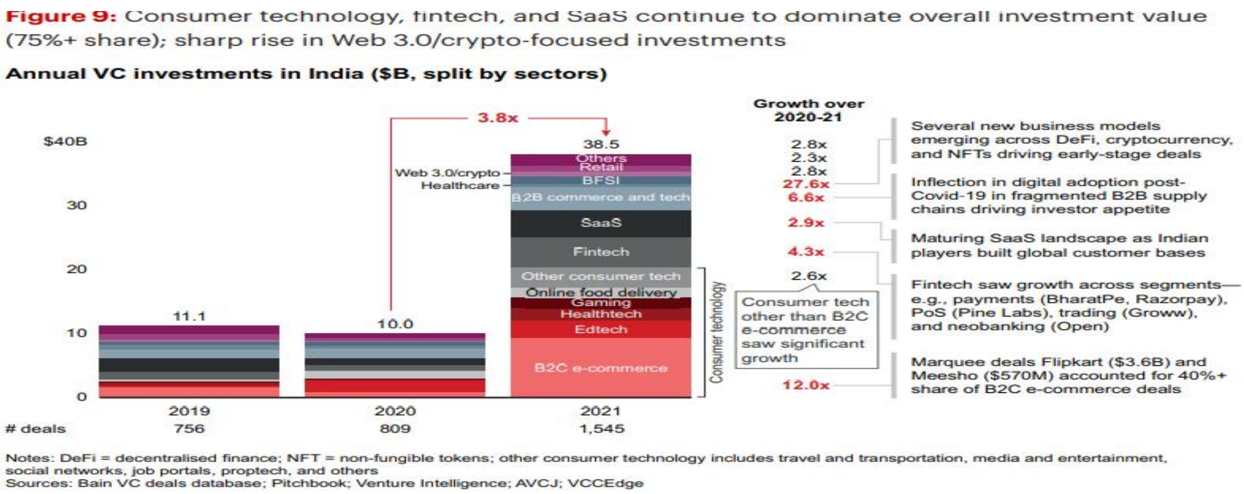
- Mergers and acquisitions
- Price reductions/other measures to drive out competitors
- Financing the steps toward an initial public offering

Growth and future of Venture capital financing in India.

According to Bain and Company 2021 was a pivotal year for the Indian venture capital (VC) investment landscape—a convergence of heady tailwinds coming together in a record growth year as VC funding reached $38.5B with several highlights:

- Investments in India grew 3.8x over 2020, faster than China's (1.3x)
- Share of VC funding in India accounted for greater than 50% of overall private equity (PE) and VC investments in the country in 2021
- 44 unicorns were minted in India, exceeding China's 42 unicorns in the year.

However, the year 2022 has seen the investors tightening their belts across start-ups, more so in the growth sectors of ecommerce, edtech and healthcare. Investment in these sectors more than halved in 2022 over last year. According to the financial advisors we can be optimistic about 2023 as there are several funds that have raised significant capital in 2021/2022 and they would look to pick interesting opportunities in the market."



*Reference: Bain and company report 2022***.**

Research Methodology: The study is based on secondary sources of data and information. Different journals, newspapers and relevant websites have been consulted in order to make the study an effective one. The study attempts to provide an insight on the future of VC financing and growth of the startups.

Data analysis and interpretation:

Image 1.1: Venture capital deal stage for startups.

Investment Stage	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	AAGR	SSD
Early	23 (38)	44 (41)	98 (35)	50 (45)	27 (35)	18 (32)	19 (27)	28 (19)	59 (20)	48 (16)	73.24	26.75
Growth	12 (20)	25 (23)	76 (27)	24 (22)	26 (33)	20 (36)	13 (18)	24 (16)	42 (14)	53 (18)	83.63	21.22
Late	8 (13)	18 (17)	52 (19)	16 (14)	18 (23)	8 (14)	15 (21)	40 (27)	104 (35)	109 (38)	92.05	38.00
PIP	14 (23)	14 (13)	37 (13)	12 (11)	3 (4)	4 (7)	16 (22)	49 (34)	71 (23)	67 (23)	107.23	25.20
Buyout	3 (6)	6 (6)	10 (6)	8 (7)	4 (5)	6 (11)	8 (11)	5 (4)	23 (8)	13 (5)	55.36	5.97
Total	60 (100)	107 (100)	280 (100)	110 (100)	78 (100)	56 (100)	71 (100)	146 (100)	299 (100)	290 (100)	77.23	105.50

Source:ACVJ 2022 edition, venture intelligence report Note: Figures in parentheses show %age weight of the cell value in total.

Image 1.2: Stage wise features of VC Investment in India.

	Early	**Growth**	**Late**	**PIPE**	**Buyout**	**All**
Average(Rs. Million)	**5773**	**9657**	**36800**	**19466**	**12977**	**84003**
Minimum(Rs. Million)	**336**	**144**	**00**	**129.20**	**190.80**	**800**
Maximum(Rs. Million)	**10272**	**17402**	**225720**	**87480**	**57480**	**396000**
S.D	**3257.93**	**6715.35**	**72093**	**29836**	**20700**	**127828**
CAGR	**.25**	**.32**	**.70**	**.50**	**.52**	**.44**

Source: ACVJ 2022 edition, Venture Intelligence report

Interpretation:
Venture capital investment generally takes place in different stageslike early stage, growth stage, late stage, PIPE stage and buyout stage. Table 1.1indicates the number of deals done in various stages during the years. It has been observed that particularly after 2015, the proportionof dealsin early stagehave been reduced and of growth, late and PIPE stages have increased. The AAGR of these three stages has been found higher than the early stage. Table 1.2contains the essentials of stage wise VC investment in India. The overall CAGR ofvc investment has been found to be .44. As compared to this overall growth rate, the CAGR of late stage vc financing has been observed to be highest followed by PIPE and buyout stages. The CAGR of early and growth stage financing was relatively less compared to these stages. However,interesting trend is that the late-stage financing got a boostonly after 2017.The reasons quoted by the selected venture capitalists include the less risky investment, shorter investment life span preference and possibility of diversification.

Conclusion:

To conclude the study,venture capital is a vital source of funding for high-growth startups in India and plays an important role in spurring job creation and economic productivity. This paper examines the benefits and opportunities that entrepreneurs will receive while working with venture capital firms, as well as the importance of venture capital funding in the corporate world. An entrepreneur may benefit from the assistance of a venture capitalist in a number of ways.

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

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